PERMA FIX ENVIRONMENTAL SERVICES INC
Form S-3/A
May 26, 2009

As filed with the Securities and Exchange Commission on May 26, 2009
Registration No. 333-158472

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

AMENDMENT NO. 2
FORM S-3/A

REGISTRATION STATEMENT UNDER THE SECURITIES ACT OF 1933

PERMA-FIX ENVIRONMENTAL SERVICES, INC.
(Exact name of registrant as specified in charter)

DELAWARE	58-1954497
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

8302 Dunwoody Place, #250
Atlanta, Georgia 30350
(770) 587-9898
(Address, including zip code, and telephone number, including area code, of registrant's principal executive office)

DR. LOUIS F. CENTOFANTI
Chairman of the Board
Perma-Fix Environmental Services, Inc.
8302 Dunwoody Place, #250
Atlanta, Georgia 30350
(770) 587-9898
(Address, including zip code, and telephone number, including area code, of agent for service)
Copy to:
Irwin H. Steinhorn, Esquire
Conner & Winters, LLP
One Leadership Square, Suite 1700
211 North Robinson
Oklahoma City, Oklahoma 73102
(405) 272-5711

Approximate date of commencement of proposed sale to the public: From time to time after this Registration Statement becomes effective.

If the only securities being registered on this form are being offered pursuant to a dividend or interest reinvestment plans, please check the following box: ¨

If any of the securities being registered on this Form are to be offered on a delayed or continuous basis pursuant to Rule 415 under the Securities Act of 1933, other than securities offered only in connection with dividend or interest reinvestment plans, check the following box: x

If this Form is filed to register additional securities for an offering pursuant to Rule 462(b) under the Securities Act, check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering: ¨

If this Form is a post-effective amendment filed pursuant to Rule 462(c) under the Securities Act, check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering: ¨

If this Form is a registration statement pursuant to General Instruction I.D. or a post-effective amendment thereto that shall become effective upon filing with the Commission pursuant to Rule 462(e) under the Securities Act, check the following box. ¨

If this Form is a post-effective amendment to a registration statement filed pursuant to General Instruction I.D. filed to register additional securities or additional classes of securities pursuant to Rule 413(b) under the Securities Act, check the following box. ¨

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer ¨ Accelerated filer x
Non-accelerated filer ¨ (Do not check if a smaller reporting company) Smaller reporting company ¨

The registrant hereby amends this Registration Statement on such date or dates as may be necessary to delay its effective date until the Registrant shall file a further amendment which specifically states that this registration statement shall thereafter become effective in accordance with Section 8(a) of the Securities Act of 1933 or until this registration statement shall become effective on such date as the Commission, acting pursuant to said Section 8(a), may determine.

CALCULATION OF REGISTRATION FEE

Title of Each Class of Securities to be Registered	Number of Shares to be Registered	Proposed Maximum Offering Price Per Share(1)	Proposed Maximum Aggregate Offering Price(2)	Amount of Registration Fee
Common Stock, $0.01 par value	5,000,000	$ 1.94	$ 9,700,000	$ 381.22(3)
Rights attached to above shares of Common Stock under Rights Agreement(3)	5,000,000	$ 0.00	$ 0.00	$ 0.00

(1) The proposed maximum aggregate offering price, estimated solely for the purpose of calculating the registration fee, has been computed pursuant to Rule 457(c) of the Securities Act of 1933 and is based on the average of the high and low prices of Perma-Fix Environmental Services, Inc.'s common stock, $0.001 par value, on April 1, 2009, as reported by The Nasdaq Capital Markets.

(2) Each share of common stock has a Right attached to it pursuant to the Registrant's Rights Agreement, dated May 2, 2008 (as more fully described beginning on page 13 of the prospectus). These Rights are also being registered in this registration statement.

(3) Previously paid

The information in this prospectus is not complete and may be changed. We may not sell these securities until the registration statement filed with the Securities and Exchange Commission is effective. This prospectus is not an offer to sell securities, and is not soliciting an offer to buy securities in any state where the offer or sale is not permitted.

Subject to Completion: Dated May 26, 2009

PROSPECTUS

5,000,000 Shares
and the Rights attached to the shares

PERMA-FIX ENVIRONMENTAL SERVICES, INC.

Common Stock

Perma-Fix Environmental Services, Inc. may offer shares of its common stock from time to time. Each share of common stock includes an attached Right under our Rights Agreement, dated May 2, 2008. We will specify in an accompanying prospectus supplement the terms of any offering. Our common stock is traded on the NASDAQ Capital Markets under the symbol “PESI”. On May 20, 2009, the closing price of our common stock as reported on the NASDAQ Capital Markets was $2.36.

You should read this prospectus, any prospectus supplement and the documents incorporated by reference in this prospectus or any prospectus supplement carefully before you invest. This prospectus may not be used to offer and sell securities unless accompanied by a prospectus supplement.

Investing in our common stock involves a high degree of risk. You should carefully consider the Risk Factors beginning on page 2 of this prospectus before you make an investment decision.

The common stock offered by this prospectus may be offered in amounts, at prices and at terms determined at the time of the offering and may be sold directly by us to investors, through agents designated from time to time or to or through underwriters or dealers. We will set forth the names of any underwriters or agents in the accompanying prospectus supplement. For additional information on the methods of sale, you should refer to the section entitled “Plan of Distribution.” The net proceeds we expect to receive from such sale will also be set forth in a prospectus supplement.

Neither the Securities and Exchange Commission nor any state securities commission has approved or disapproved of these securities or determined if this prospectus is truthful or complete. Any representation to the contrary is a criminal offense.

The date of this prospectus is ___________, 2009.

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Unless the context otherwise requires, references in this prospectus to “Perma-Fix,” “the company,” “we,” “our,” and “us” refe to Perma-Fix Environmental Services, Inc. and its consolidated subsidiaries.

No person has been authorized to give any information or make any representations in connection with this offering other than those contained or incorporated by reference in this prospectus and any accompanying prospectus supplement in connection with the offering described herein and therein, and, if given or made, such information or representations must not be relied upon as having been authorized by us. Neither this prospectus nor any prospectus supplement shall constitute an offer to sell or a solicitation of an offer to buy offered securities in any jurisdiction in which it is unlawful for such person to make such an offering or solicitation. Neither the delivery of this prospectus or any prospectus supplement nor any sale made hereunder shall under any circumstances imply that the information contained or incorporated by reference herein or in any prospectus supplement is correct as of any date subsequent to the date hereof or of such prospectus supplement.

SUMMARY

The following summary is qualified in its entirety by the more detailed information included in this prospectus or incorporated by reference in this prospectus. You should carefully consider the information set forth in this entire prospectus, including the “Risk Factors” section, the applicable prospectus supplement for such securities and the other documents we refer to or that we incorporate by reference.

This prospectus is part of a Registration Statement on Form S-3 that we filed with the Securities and Exchange Commission, or SEC, utilizing a “shelf” registration process. Under this shelf registration process, we may, from time to time, sell up to an aggregate of 5,000,000 shares of our common stock in one or more offerings. This prospectus provides you with a general description of the securities we may offer. Each time we sell securities, we will provide a prospectus supplement that will contain specific information about the terms of that offering. The prospectus supplement may also add, update or change information contained in this prospectus. You should read both this prospectus and any prospectus supplement, including the risk factors, together with additional information described below under the heading s “Where You Can Find More Information” and “Incorporation by Reference.”

Perma-Fix

Perma-Fix Environmental Services, Inc. is an environmental and technology know-how company. We are engaged through our subsidiaries, in:

Nuclear Waste Management Services (“Nuclear Segment”), which include:

- Treatment, storage, processing and disposal of mixed waste (which is waste that contains both low-level radioactive and hazardous waste) including on and off-site waste remediation and processing;
- Nuclear, low-level radioactive, and mixed waste treatment, processing and disposal; and
- Research and development of innovative ways to process low-level radioactive and mixed waste.

These services are primarily conducted through four of our subsidiaries:

- Perma-Fix Northwest Richland, Inc. located in Richland, Washington, adjacent to the U.S. Department of Energy’s Hanford, Washington, facility;
- Perma-Fix of Florida, Inc., located in Gainesville, Florida;
- Diversified Scientific Services, Inc., located in Kingston, Tennessee; and
- East Tennessee Materials and Energy Corporation, located in Oak Ridge, Tennessee.

Industrial Waste Management Services (“Industrial Segment”), which include:

- treatment storage, processing and disposal of hazardous and non-hazardous waste, and
- wastewater management services, including the collection, treatment, processing and disposal of hazardous and non-hazardous wastewater.

These services are conducted through our subsidiaries:

- Perma-Fix of Fort Lauderdale, Inc., located in Ft. Lauderdale, Florida;
- Perma-Fix of South Georgia, Inc., located in Valdosta, Georgia; and
- Perma-Fix of Orlando, Inc., located in Orlando, Florida.

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Consulting Engineering Services ("Engineering Segment"), which provide solutions to industrial and government customers for broad-scope environmental issues including:

- Air, water, and hazardous waste permitting;
- air, soil, and water sampling;
- compliance reporting;
- emission reduction strategies; and
- compliance auditing.

The Engineering Segment also provides various compliance and training activities, as well as engineering and compliance support needed by our other segments. These services are primarily conducted through our subsidiary, Schreiber, Yonley & Associates, Inc., located in Ellisville, Missouri.

Our goal is to continue focus on the efficient operation of our existing facilities within our Nuclear, Industrial, and Engineering Segments, evaluate strategic acquisitions primarily within the Nuclear Segments, and to continue the research and development of innovative technologies to treat nuclear waste, mixed waste, and industrial waste. We continue to place greater attention and resources on our nuclear business.

We service research institutions, commercial companies, public utilities, and governmental agencies nationwide. The distribution channels for services are through direct sales to customers or via intermediaries.

We were incorporated in the State of Delaware in December 1990. Our executive offices are located at 8302 Dunwoody Place, #250, Atlanta, Georgia 30350, and our telephone number is (770) 587-9898. Our website is located at www.perma-fix.com. The information contained in our website is not incorporated by reference in this prospectus.

THE COMMON STOCK WE MAY OFFER

We may offer up to an aggregate of 5,000,000 shares of common stock in one or more offerings. A prospectus supplement, which we will provide to you each time we offer securities, will describe the specific amounts, prices and terms of these securities. Each share of common stock includes an attached Right, as described beginning on page 13 of this prospectus.

We may sell the common stock to or through underwriters, dealers or agents or directly to purchasers. We and our agents reserve the sole right to accept and to reject in whole or in part any proposed purchase of securities. Each prospectus supplement will set forth the names of any underwriters, dealers or agents involved in the sale of the common stock described in that prospectus supplement and any applicable fee, commission or discount arrangements with them.

Common stock holders are entitled to receive dividends declared by our board of directors out of funds legally available for the payment of dividends, subject to rights, if any, of preferred stock holders. However, we have never paid a dividend, and we do not anticipate paying a dividend in the foreseeable future. Our current secured credit facility prohibits us from paying cash dividends on our common stock. Each holder of common stock is entitled to one vote per share. The holders of common stock have no preemptive rights or cumulative voting rights. A prospectus supplement will describe the specific amounts, prices and terms of any common stock to be issued.

RISK FACTORS

An investment in our securities involves a high degree of risk. You should carefully consider the risks described below before making an investment decision, as well as the risks and other information included and incorporated by reference in the applicable prospectus supplement when determining whether or not to purchase the securities offered under this prospectus and the applicable prospectus supplement. You should also refer to the other information in this prospectus incorporated by reference into this prospectus and the additional information in the other reports we file with the Securities and Exchange Commission ("SEC").

If any of the following risks actually occur, our business, results of operations and financial condition could suffer. In that event, the trading price of our common stock could decline, and you may lose all or part of your investment in our common stock. The risks discussed below also include forward-looking statements and our actual results may differ substantially from those discussed in these forward-looking statements.

Risks Relating to our Operations

Our insurer that provides our financial assurance that we are required have in order to operate our permitted treatment, storage and disposal facility has experienced financial difficulties.

It has been publicly reported that American International Group, Inc. ("AIG"), has experienced significant financial difficulties and is continuing to experience significant financial difficulties. A subsidiary of AIG provides our finite risk insurance policies which provide financial assurance to the applicable states for our permitted facilities in the event of unforeseen closure. We are required to provide and to maintain financial assurance that guarantees to the state that in the event of closure of our permitted facilities will be closed in accordance with the regulations. The policies provide a maximum of $35,000,000 of financial assurance coverage of which the coverage amount totals $32,515,000 at December 31, 2008. In March 2009, the policies were increased to provide a maximum of $39,000,000 of financial assurance coverage of which the coverage amounts totals $37,936,000. This additional increase was the result of additional financial assurance coverage requirement for our DSSI subsidiary to commercially store and dispose of PCB wastes under a permit issued by the EPA on November 26, 2008. The AIG subsidiary also provides other operating insurance policies for the Company and our subsidiaries. In the event of a failure of AIG, this could materially impact our operations and our permits which we are required to have in order to operate our treatment, storage, and disposal facilities.

If we cannot maintain adequate insurance coverage, we will be unable to continue certain operations.

Our business exposes us to various risks, including claims for causing damage to property and injuries to persons that may involve allegations of negligence or professional errors or omissions in the performance of our services. Such claims could be substantial. We believe that our insurance coverage is presently adequate and similar to, or greater than, the coverage maintained by other companies in the industry of our size. If we are unable to obtain adequate or required insurance coverage in the future, or if our insurance is not available at affordable rates, we would violate our permit conditions and other requirements of the environmental laws, rules, and regulations under which we operate. Such violations would render us unable to continue certain of our operations. These events would have a material adverse effect on our financial condition.

The inability to maintain existing government contracts or win new government contracts over an extended period could have a material adverse effect on our operations and adversely affect our future revenues.

A material amount of our Nuclear Segment's revenues are generated through various U.S. government contracts or subcontracts involving the U.S. government. Our revenues from governmental contracts and subcontracts relating to governmental facilities within our Nuclear Segment were approximately $43,464,000 and $30,000,000, representing 57.6% and 46.5%, respectively, of our consolidated operating revenues from continuing operations for 2008 and 2007. Most of our government contracts or our subcontracts granted under government contracts are awarded through a regulated competitive bidding process. Some government contracts are awarded to multiple competitors, which increase overall competition and pricing pressure and may require us to make sustained post-award efforts to realize revenues under these government contracts. All contracts with, or subcontracts involving, the federal government are terminable, or subject to renegotiation, by the applicable governmental agency on 30 days notice, at the option of the governmental agency. If we fail to maintain or replace these relationships, or if a material contract is terminated or renegotiated in a manner that is materially adverse to us, our revenues and future operations could be materially adversely affected.

Failure of our Nuclear Segment to be profitable could have a material adverse effect.

Our Nuclear Segment has historically been profitable. With the divestitures of certain facilities within our Industrial Segment and the acquisition of our Perma-Fix Northwest Richland, Inc. ("PFNWR") within our Nuclear Segment in June 2007, the Nuclear Segment represents the Company's largest revenue segment. The Company's main objectives are to increase focus on the efficient operation of our existing facilities within our Nuclear Segment and to further evaluate strategic acquisitions within the Nuclear Segment. If our Nuclear Segment fails to continue to be profitable in the future, this could have a material adverse effect on the Company's results of operations, liquidity and our potential growth.

Our existing and future customers may reduce or halt their spending on nuclear services with outside vendors, including us.

A variety of factors may cause our existing or future customers (including the federal government) to reduce or halt their spending on nuclear services from outside vendors, including us. These factors include, but are not limited to:

- accidents, terrorism, natural disasters or other incidents occurring at nuclear facilities or involving shipments of nuclear materials;
- failure of the federal government to approve necessary budgets, or to reduce the amount of the budget necessary, to fund remediation of U.S. Department of Energy ("DOE") and U.S. Department of Defense ("DOD") sites;
- civic opposition to or changes in government policies regarding nuclear operations; or
- a reduction in demand for nuclear generating capacity.

These events could result in or cause the federal government to terminate or cancel its existing contracts involving us to treat, store or dispose of contaminated waste at one or more of the federal sites since all contracts with, or subcontracts involving, the federal government are terminable upon or subject to renegotiation at the option of the government on 30 days notice. These events also could adversely affect us to the extent that they result in the reduction or elimination of contractual requirements, lower demand for nuclear services, burdensome regulation, disruptions of shipments or production, increased operational costs or difficulties or increased liability for actual or threatened property damage or personal injury.

Economic downturns (i.e. the current economic recession) and/or reductions in government funding could have a material negative impact on our businesses.

Demand for our services has been, and we expect that demand will continue to be, subject to significant fluctuations due to a variety of factors beyond our control, including the current economic recession and conditions, inability of the federal government to adopt its budget or reductions in the budget for spending to remediate federal sites due to numerous reasons, including, without limitation, the substantial deficits that the federal government has and is continuing to incur. During economic downturns, such as the current economic recession, and large budget deficits that the federal government and many states are experiencing, the ability of private and government entities to spend on nuclear services may decline significantly. Although the recently adopted economic stimulus package provides for substantial funds to remediate federal nuclear sites, we cannot be certain that economic or political conditions will be generally favorable or that there will not be significant fluctuations adversely affecting our industry as a whole. In addition, our operations depend, in large part, upon governmental funding, particularly funding levels at the DOE. Significant reductions in the level of governmental funding (for example, the annual budget of the DOE) or specifically mandated levels for different programs that are important to our business could have a material adverse impact on our business, financial position, results of operations and cash flows.

The loss of one or a few customers could have an adverse effect on us.

One or a few governmental customers or governmental related customers have in the past, and may in the future, account for a significant portion of our revenue in any one year or over a period of several consecutive years. Because customers generally contract with us for specific projects, we may lose these significant customers from year to year as their projects with us are completed. Our inability to replace the business with other projects could have an adverse effect on our business and results of operations.

As a government contractor, we are subject to extensive government regulation, and our failure to comply with applicable regulations could subject us to penalties that may restrict our ability to conduct our business.

Our governmental contracts, which are primarily with the DOE or subcontracts relating to DOE sites, are a significant part of our business. Allowable costs under U.S. government contracts are subject to audit by the U.S. government. If these audits result in determinations that costs claimed as reimbursable are not allowed costs or were not allocated in accordance with applicable regulations, we could be required to reimburse the U.S. government for amounts previously received.

Governmental contracts or subcontracts involving governmental facilities are often subject to specific procurement regulations, contract provisions and a variety of other requirements relating to the formation, administration, performance and accounting of these contracts. Many of these contracts include express or implied certifications of compliance with applicable regulations and contractual provisions. If we fail to comply with any regulations, requirements or statutes, our existing governmental contracts or subcontracts involving governmental facilities could be terminated or we could be suspended from government contracting or subcontracting. If one or more of our governmental contracts or subcontracts are terminated for any reason, or if we are suspended or debarred from government work, we could suffer a significant reduction in expected revenues and profits. Furthermore, as a result of our governmental contracts or subcontracts involving governmental facilities, claims for civil or criminal fraud may be brought by the government or violations of these regulations, requirements or statutes.

Loss of certain key personnel could have a material adverse effect on us.

Our success depends on the contributions of our key management, environmental and engineering personnel, especially Dr. Louis F. Centofanti, Chairman, President, and Chief Executive Officer. The loss of Dr. Centofanti could have a material adverse effect on our operations, revenues, prospects, and our ability to raise additional funds. Our future success depends on our ability to retain and expand our staff of qualified personnel, including environmental specialists and technicians, sales personnel, and engineers. Without qualified personnel, we may incur delays in rendering our services or be unable to render certain services. We cannot be certain that we will be successful in our efforts to attract and retain qualified personnel as their availability is limited due to the demand for hazardous waste management services and the highly competitive nature of the hazardous waste management industry. We do not maintain key person insurance on any of our employees, officers, or directors.

Changes in environmental regulations and enforcement policies could subject us to additional liability and adversely affect our ability to continue certain operations.

We cannot predict the extent to which our operations may be affected by future governmental enforcement policies as applied to existing laws, by changes to current environmental laws and regulations, or by the enactment of new environmental laws and regulations. Any predictions regarding possible liability under such laws are complicated further by current environmental laws which provide that we could be liable, jointly and severally, for certain activities of third parties over whom we have limited or no control.

The refusal to accept our waste for disposal by, or a closure of, the end disposal site that our Nuclear Segment utilizes to dispose of its waste could subject us to significant risk and limit our operations.

Our Nuclear Segment has limited options available for disposal of its waste. If this disposal site ceases to accept waste or closes for any reason or refuses to accept the waste of our Nuclear Segment, for any reason, we could have nowhere to dispose of our nuclear waste or have significantly increased costs from disposal alternatives. With nowhere to dispose of our nuclear waste, we would be subject to significant risk from the implications of storing the waste on our site, and we would have to limit our operations to accept only waste that we can dispose of.

Our businesses subject us to substantial potential environmental liability.

Our business of rendering services in connection with management of waste, including certain types of hazardous waste, low-level radioactive waste, and mixed waste (waste containing both hazardous and low-level radioactive waste), subjects us to risks of liability for damages. Such liability could involve, without limitation:

- claims for clean-up costs, personal injury or damage to the environment in cases in which we are held responsible for the release of hazardous or radioactive materials; and

- claims of employees, customers, or third parties for personal injury or property damage occurring in the course of our operations; and
- claims alleging negligence or professional errors or omissions in the planning or performance of our services.

Our operations are subject to numerous environmental laws and regulations. We have in the past, and could in the future, be subject to substantial fines, penalties, and sanctions for violations of environmental laws and substantial expenditures as a responsible party for the cost of remediating any property which may be contaminated by hazardous substances generated by us and disposed at such property, or transported by us to a site selected by us, including properties we own or lease.

As our operations expand, we may be subject to increased litigation, which could have a negative impact on our future financial results.

Our operations are highly regulated and we are subject to numerous laws and regulations regarding procedures for waste treatment, storage, recycling, transportation, and disposal activities, all of which may provide the basis for litigation against us. In recent years, the waste treatment industry has experienced a significant increase in so-called "toxic-tort" litigation as those injured by contamination seek to recover for personal injuries or property damage. We believe that, as our operations and activities expand, there will be a similar increase in the potential for litigation alleging that we have violated environmental laws or regulations or are responsible for contamination or pollution caused by our normal operations, negligence or other misconduct, or for accidents, which occur in the course of our business activities. Such litigation, if significant and not adequately insured against, could adversely affect our financial condition and our ability to fund our operations. Protracted litigation would likely cause us to spend significant amounts of our time, effort, and money. This could prevent our management from focusing on our operations and expansion.

Our operations are subject to seasonal factors, which cause our revenues to fluctuate.

We have historically experienced reduced revenues and losses during the first and fourth quarters of our fiscal years due to a seasonal slowdown in operations from poor weather conditions, overall reduced activities during these periods resulting from holiday periods, and finalization of government budgets during the fourth quarter of each year. During our second and third fiscal quarters there has historically been an increase in revenues and operating profits. If we do not continue to have increased revenues and profitability during the second and third fiscal quarters, this will have a material adverse effect on our results of operations and liquidity.

If environmental regulation or enforcement is relaxed, the demand for our services will decrease.

The demand for our services is substantially dependent upon the public's concern with, and the continuation and proliferation of, the laws and regulations governing the treatment, storage, recycling, and disposal of hazardous, non-hazardous, and low-level radioactive waste. A decrease in the level of public concern, the repeal or modification of these laws, or any significant relaxation of regulations relating to the treatment, storage, recycling, and disposal of hazardous waste and low-level radioactive waste would significantly reduce the demand for our services and could have a material adverse effect on our operations and financial condition. We are not aware of any current federal or state government or agency efforts in which a moratorium or limitation has been, or will be, placed upon the creation of new hazardous or radioactive waste regulations that would have a material adverse effect on us; however, no assurance can be made that such a moratorium or limitation will not be implemented in the future.

We and our customers operate in a politically sensitive environment, and the public perception of nuclear power and radioactive materials can affect our customers and us.

We and our customers operate in a politically sensitive environment. Opposition by third parties to particular projects can limit the handling and disposal of radioactive materials. Adverse public reaction to developments in the disposal of radioactive materials, including any high profile incident involving the discharge of radioactive materials, could directly affect our customers and indirectly affect our business. Adverse public reaction also could lead to increased regulation or outright prohibition, limitations on the activities of our customers, more onerous operating requirements or other conditions that could have a material adverse impact on our customers' and our business.

We may not be successful in winning new business mandates from our government and commercial customers.

We must be successful in winning mandates from our government and commercial customers to replace revenues from projects that are nearing completion and to increase our revenues. Our business and operating results can be adversely affected by the size and timing of a single material contract.

The elimination or any modification of the Price-Anderson Acts indemnification authority could have adverse consequences for our business.

The Atomic Energy Act of 1954, as amended, or the AEA, comprehensively regulates the manufacture, use, and storage of radioactive materials. The Price-Anderson Act supports the nuclear services industry by offering broad indemnification to DOE contractors for liabilities arising out of nuclear incidents at DOE nuclear facilities. That indemnification protects DOE prime contractor, but also similar companies that work under contract or subcontract for a DOE prime contract or transporting radioactive material to or from a site. The indemnification authority of the DOE under the Price-Anderson Act was extended through 2025 by the Energy Policy Act of 2005.

The Price-Anderson Act's indemnification provisions generally do not apply to our processing of radioactive waste at governmental facilities, and do not apply to liabilities that we might incur while performing services as a contractor for the DOE and the nuclear energy industry. If an incident or evacuation is not covered under Price-Anderson Act indemnification, we could be held liable for damages, regardless of fault, which could have an adverse effect on our results of operations and financial condition. If such indemnification authority is not applicable in the future, our business could be adversely affected if the owners and operators of new facilities fail to retain our services in the absence of commercial adequate insurance and indemnification.

We are engaged in highly competitive businesses and typically must bid against other competitors to obtain major contracts.

We are engaged in highly competitive business in which most of our government contracts and some of our commercial contracts are awarded through competitive bidding processes. We compete with national and regional firms with nuclear services practices, as well as small or local contractors. Some of our competitors have greater financial and other resources than we do, which can give them a competitive advantage. In addition, even if we are qualified to work on a new government contract, we might not be awarded the contract because of existing government policies designed to protect certain types of businesses and underrepresented minority contractors. Competition also places downward pressure on our contract prices and profit margins. Intense competition is expected to continue for nuclear service contracts. If we are unable to meet these competitive challenges, we could lose market share and experience on overall reduction in our profits.

Our failure to maintain our safety record could have an adverse effect on our business.

Our safety record is critical to our reputation. In addition, many of our government and commercial customers require that we maintain certain specified safety record guidelines to be eligible to bid for contracts with these customers. Furthermore, contract terms may provide for automatic termination in the event that our safety record fails to adhere to agreed-upon guidelines during performance of the contract. As a result, our failure to maintain our safety record could have a material adverse effect on our business, financial condition and results of operations.

We continue to have material weaknesses in our Internal Control over Financial Reporting ("ICFR").

During our evaluation of our ICFR, we noted that the monitoring of invoicing process controls and the corresponding transportation and disposal process controls at our Industrial Segment subsidiaries were ineffective and were not being applied consistently. In addition, we noted that the monitoring of quote to invoicing control was ineffective at certain of our Nuclear Segment subsidiaries. These deficiencies resulted in material weaknesses to our ICFR, and could result in sales being priced and invoiced at amounts which were not approved by the customer, or the appropriate level of management, and recognition of revenue in incorrect financial reporting period. These deficiencies have resulted in our disclosure that our ICFR was ineffective as of the end of 2008 and 2007. Although these material weaknesses did not result in a material adjustment to our quarterly or annual financial statements, if we are unable to remediate these material weaknesses, there is a reasonable possibility that a misstatement of our annual or interim financial statements will not be prevented or detected on a timely basis.

We may be unable to utilize loss carryforwards in the future.

We have approximately $26,589,000 in net operating loss carryforwards which will expire from 2009 to 2028 if not used against future federal income tax liabilities. Our net loss carryforwards are subject to various limitations. Our ability to use the net loss carryforwards depends on whether we are able to generate sufficient income in the future years. Further, our net loss carryforwards have not been audited or approved by the Internal Revenue Service.

Risks Relating to our Intellectual Property

If we cannot maintain our governmental permits or cannot obtain required permits, we may not be able to continue or expand our operations.

We are a waste management company. Our business is subject to extensive, evolving, and increasingly stringent federal, state, and local environmental laws and regulations. Such federal, state, and local environmental laws and regulations govern our activities regarding the treatment, storage, recycling, disposal, and transportation of hazardous and non-hazardous waste and low-level radioactive waste. We must obtain and maintain permits or licenses to conduct these activities in compliance with such laws and regulations. Failure to obtain and maintain the required permits or licenses would have a material adverse effect on our operations and financial condition. If any of our facilities are unable to maintain currently held permits or licenses or obtain any additional permits or licenses which may be required to conduct its operations, we may not be able to continue those operations at these facilities, which could have a material adverse effect on us.

We believe our proprietary technology is important to us.

We believe that it is important that we maintain our proprietary technologies. There can be no assurance that the steps taken by us to protect our proprietary technologies will be adequate to prevent misappropriation of these technologies by third parties. Misappropriation of our proprietary technology could have an adverse effect on our operations and financial condition. Changes to current environmental laws and regulations also could limit the use of our proprietary technology.

Risks Relating to our Financial Position and Need for Financing

Breach of financial covenants in existing credit facility could result in a default, triggering repayment of outstanding debt under the credit facility.

Our credit facility with our bank contains financial covenants. A breach of any of these covenants could result in a default under our credit facility triggering our lender to immediately require the repayment of all outstanding debt under our credit facility and terminate all commitments to extend further credit. In the past, none of our covenants have been restrictive to our operations. If we fail to meet our loan covenants in the future and our lender does not waive the non-compliance or revise our covenant so that we are in compliance, our lender could accelerate the repayment of borrowings under our credit facility. In the event that our lender accelerates the payment of our borrowing, we may not have sufficient liquidity to repay our debt under our credit facility and other indebtedness.

Our amount of debt and floating rates of interest could adversely affect our operations.

At December 31, 2008, our aggregate consolidated debt was approximately $16,203,000. If our floating rates of interest experienced an upward increase of 1%, our debt service would increase by approximately $162,000 annually. Our secured revolving credit facility (the “Credit Facility”) provides for an aggregate commitment of $25,000,000, consisting of an $18,000,000 revolving line of credit and a term loan of $7,000,000. The maximum we can borrow under the revolving part of the Credit Facility is based on a percentage of the amount of our eligible receivables outstanding at any one time. As of December 31, 2008, we had borrowings under the revolving part of our Credit Facility of $6,500,000 and borrowing availability of up to an additional $5,400,000 based on our outstanding eligible receivables. A lack of operating results could have material adverse consequences on our ability to operate our business. Our ability to make principal and interest payments, or to refinance indebtedness, will depend on both our and our subsidiaries' future operating performance and cash flow. Prevailing economic conditions, interest rate levels, and financial, competitive, business, and other factors affect us. Many of these factors are beyond our control.

Risks Relating to an Investment in our Common Stock

Issuance of substantial amounts of our common stock could depress our stock price.

Any sales of substantial amounts of our Common Stock in the public market could cause an adverse effect on the market price of our Common Stock and could impair our ability to raise capital through the sale of additional equity securities. The issuance of our Common Stock will result in the dilution in the percentage membership interest of our stockholders and the dilution in ownership value. As of March 31, 2009, we had 53,985,119 shares of Common Stock outstanding.

In addition, as of March 31, 2009, we had outstanding options to purchase 3,558,347 shares of common stock at exercise prices from $1.22 to $2.98 per share. Further, we have adopted a preferred share rights plan, and if such is triggered, could result in the issuance of a substantial amount of our common stock. The existence of this quantity of rights to purchase our common stock could result in a significant dilution in the percentage ownership interest of our stockholders and the dilution in ownership value. Future sales of the shares issuable could also depress the market price of our common stock.

We do not intend to pay dividends on our common stock in the foreseeable future.

Since our inception, we have not paid cash dividends on our common stock, and we do not anticipate paying any cash dividends in the foreseeable future. Our Credit Facility prohibits us from paying cash dividends on our common stock.

The price of our common stock may fluctuate significantly, which may make it difficult for you to resell our common stock when you want or at prices you find attractive.

The price of our common stock on the Nasdaq Capital Markets constantly changes. We expect that the market price of our common stock will continue to fluctuate. This may make it difficult for you to resell the common stock when you want or at prices you find attractive.

Future issuance or potential issuance of our common stock could adversely affect the price of our common stock, our ability to raise funds in new stock offerings and dilute your percentage interest in our common stock.

Future sales of substantial amounts of our common stock in the public market, or the perception that such sales could occur, could adversely affect prevailing trading prices of our common stock, and impair our ability to raise capital through future offerings of equity. No prediction can be made as to the effect, if any, that future issuances or sales of shares of common stock or the availability of shares of common stock for future issuance, will have on the trading price of our common stock. Such future issuances could also significantly reduce the percentage ownership and dilute the ownership value of our existing common stockholders.

Delaware law, certain of our charter provisions, our stock option plans and outstanding warrants and our preferred stock may inhibit a change of control under circumstances that could give you an opportunity to realize a premium over prevailing market prices.

We are a Delaware corporation governed, in part, by the provisions of Section 203 of the General Corporation Law of Delaware, an anti-takeover law. In general, Section 203 prohibits a Delaware public corporation from engaging in a "business combination" with an "interested stockholder" for a period of three years after the date of the transaction in which the person became an interested stockholder, unless the business combination is approved in a prescribed manner. As a result of Section 203, potential acquirers may be discouraged from attempting to effect acquisition transactions with us, thereby possibly depriving our security holders of certain opportunities to sell, or otherwise dispose of, such securities at above-market prices pursuant to such transactions. Further, certain of our option plans provide for the immediate acceleration of, and removal of restrictions from, options and other awards under such plans upon a "change of control" (as defined in the respective plans). Such provisions may also have the result of discouraging acquisition of us.

We have authorized and unissued 17,456,534 (which include outstanding options to purchase 3,558,347 shares of our Common Stock) shares of Common Stock and 2,000,000 shares of Preferred Stock as of March 31, 2009 (which includes 600,000 shares of our Preferred Stock reserved for issuance under our preferred share rights plan). These unissued shares could be used by our management to make it more difficult, and thereby discourage an attempt to acquire control of us.

Our Preferred Share Rights Plan may adversely affect our stockholders.

In May 2008, we adopted a preferred share rights plan (the "Rights Plan"), designed to ensure that all of our stockholders receive fair and equal treatment in the event of a proposed takeover or abusive tender offer. However, the Rights Plan may also have the effect of deterring, delaying, or preventing a change in control that might otherwise be in the best interests of our stockholders.

In general, under the terms of the Rights Plan, subject to certain limited exceptions, if a person or group acquires 20% or more of our common stock or a tender offer or exchange offer for 20% or more of our common stock is announced or commenced, our other stockholders may receive upon exercise of the rights (the "Rights") issued under the Rights Plan the number of shares our common stock or of one-one hundredths of a share of our Series A Junior Participating Preferred Stock, par value $.001 per share, having a value equal to two times the purchase price of the Right. In addition, if we are acquired in a merger or other business combination transaction in which we are not the survivor or more than 50% of our assets or earning power is sold or transferred, then each holder of a Right (other than the acquirer) will thereafter have the right to receive, upon exercise, common stock of the acquiring company having a value equal to two times the purchase price of the Right. The purchase price of each Right is $13, subject to adjustment.

The Rights will cause substantial dilution to a person or group that attempts to acquire us on terms not approved by our board of directors. The Rights may be redeemed by us at $0.001 per Right at any time before any person or group acquires 20% or more of our outstanding common stock. The rights should not interfere with any merger or other business combination approved by our board of directors. The Rights expire on May 2, 2018.

Resale of shares offered by this prospectus could adversely affect the market price of our common stock and our ability to raise additional equity capital.

The sale, or availability for sale, of common stock in the public market pursuant to this prospectus may adversely affect the prevailing market price of our common stock and may impair our ability to raise additional capital by selling equity or equity-related securities. This prospectus includes 5,000,000 shares that will be available for resale (assuming the issuance from time to time of all of the common stock included in this offering). The resale of a substantial number of shares of our common stock in the public market pursuant to this offering, and afterwards, could adversely affect the market price for our common stock and make it more difficult for you to sell our shares at times and prices that you feel are appropriate.

SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS

Certain statements contained within this prospectus and the documents incorporated into this prospectus by reference may be deemed "forward-looking statements" within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended (collectively, the "Private Securities Litigation Reform Act of 1995"). All statements in this prospectus and the documents incorporated into this prospectus by reference other than a statement of historical fact are forward-looking statements that are subject to known and unknown risks, uncertainties and other factors, which could cause actual results and performance of the Company to differ materially from such statements. The words "believe," "expect," "anticipate," "intend," "will," "may," and similar expressions identify forward-looking statements. Forward-looking statements include, without limitation, the statements listed under "Special Note Regarding Forward-Looking Statements" in our 2008 Form 10-K, all of which are incorporated by reference herein, as well as those forward-looking statements identified in our other SEC filings incorporated by reference in this prospectus.

While we believe the expectations reflected in such forward-looking statements are reasonable, we can give no assurance such expectations will prove to be correct. There are a variety of factors which could cause future outcomes to differ materially from those described in this report, including, but not limited to:

- general economic conditions;
- material reduction in revenues;
- inability to collect in a timely manner a material amount of receivables;
- increased competitive pressures;
- the ability to maintain and obtain required permits and approvals to conduct operations;
- the ability to develop new and existing technologies in the conduct of operations;
- ability to retain or renew certain required permits;
- discovery of additional contamination or expanded contamination at any of the sites or facilities leased or owned by us or our subsidiaries which would result in a material increase in remediation expenditures;
- changes in federal, state and local laws and regulations, especially environmental laws and regulations, or in interpretation of such;
- potential increases in equipment, maintenance, operating or labor costs;
- management retention and development;
- financial valuation of intangible assets is substantially more/less than expected;
- the requirement to use internally generated funds for purposes not presently anticipated;
- the inability to maintain the listing of our Common Stock on the NASDAQ;
- terminations of contracts with federal agencies or subcontracts involving federal agencies, or reduction in amount of waste delivered to us under these contracts or subcontracts;
- disposal expense accrual could prove to be inadequate in the event the waste requires retreatment; and
- other factors described under "Risk Factors" in this prospectus and in the other documents we have filed with the SEC and that are incorporated herein by reference, including the factors described under "Business," "Risk Factors," "Management's Discussion and Analysis of Financial Condition and Results of Operations" and elsewhere in our annual report on Form 10-K for the fiscal year ended December 31, 2008 and that may be discussed from time to time in other reports filed with the SEC subsequent to the registration statement of which this prospectus is a part.

Any forward-looking statement speaks only as to the date on which that statement is made. We undertake no obligation to update publicly any forward-looking statement, whether as a result of new information, future events or otherwise.

USE OF PROCEEDS

Unless otherwise indicated in the prospectus supplement, we intend to use the net proceeds from the sale of the securities offered by this prospectus for general corporate purposes and working capital requirements, which may include the repayment of indebtedness. Under the terms of our existing Credit Facility, we may also use a portion of the net proceeds to fund possible investments in and acquisitions of complimentary businesses, partnerships, minority investments, products or technologies with the consent of our Credit Facility lender. Currently, there are no commitments or agreements regarding such acquisitions or investments that are material. Pending their ultimate use, we intend to invest the net proceeds in money market funds, commercial paper and governmental and non-governmental debt securities with maturities of up to three years. The terms of our existing Credit Facility require us to maintain such investments with our Credit Facility lender or its affiliates, which investments serve as additional collateral under the Credit Facility.

PLAN OF DISTRIBUTION

We may sell the securities:

- through one or more underwriters or dealers,
- directly to purchasers,
- through agents, or
- through a combination of any of these methods of sale.

We may distribute the securities:

- from time to time in one or more transactions at a fixed price or prices, which may be changed from time to time,
- at market prices prevailing at the times of sale,
- at prices related to such prevailing market prices, or
- at negotiated prices.

We will describe the method of distribution of the securities in the applicable prospectus supplement.

We may determine the price or other terms of the securities offered under this prospectus by use of an electronic auction. We will describe how any auction will determine the price or any other terms, how potential investors may participate in the auction and the nature of the obligations of the underwriter, dealer or agent in the applicable prospectus supplement.

If underwriters are used in the sale, they will acquire the common stock for their own account and may resell the stock from time to time in one or more transactions at a fixed public offering price. The obligations of the underwriters to purchase the common stock will be subject to the conditions set forth in the applicable underwriting agreement. We may offer the common stock to the public through underwriting syndicates represented by managing underwriters or by underwriters without a syndicate. Underwriters, dealers or agents may receive compensation in the form of discounts, concessions or commissions from us or our purchasers (as their agents in connection with the sale of securities). These underwriters, dealers or agents may be considered to be underwriters under the Securities Act. As a result, discounts, commissions, or profits on resale received by the underwriters, dealers or agents may be treated as underwriting discounts and commissions. Each prospectus supplement will identify any such underwriter, dealer or agent, and describe any compensation received by them from us. Any initial public offering price and any discounts or concessions allowed or reallowed or paid to dealers may be changed from time to time.

Underwriters, dealers and agents may be entitled to indemnification by us against certain civil liabilities, including liabilities under the Securities Act, or to contribution with respect to payments made by the underwriters, dealers or agents, under agreements between us and the underwriters, dealers and agents.

We may grant underwriters who participate in the distribution of securities an option to purchase additional securities to cover over-allotments, if any, in connection with the distribution.

Underwriters or agents and their associates may be customers of, engage in transactions with or perform services for us in the ordinary course of business.

In connection with the offering of our common stock, certain persons participating in such offering may engage in transactions that stabilize, maintain or otherwise affect the market price, including over-allotment, stabilizing transactions, short covering transactions and penalty bids in accordance with Regulation M under the Exchange Act. Over-allotment involves sales in excess of the offering size, which create a short position. Stabilizing transactions permit bids to purchase the underlying security so long as the stabilizing bids do not exceed a specified maximum. Short covering transactions involve purchases of the common stock in the open market after the distribution is completed to cover short positions. Penalty bids permit the underwriters to reclaim a selling concession from a dealer when the common stock originally sold by the dealer is purchased in a covering transaction to cover short positions. Those activities may cause the price of the common stock to be higher than it would otherwise be. If commenced, the underwriters may discontinue any of the activities at any time.

Any underwriters who are qualified market makers on the NASDAQ Capital Markets may engage in passive market making transactions in the common stock on the NASDAQ Capital Global Markets in accordance with Rule 103 of Regulation M, during the business day prior to the pricing of the offering, before the commencement of offers or sales of the common stock. Passive market makers must comply with applicable volume and price limitations and must be identified as passive market makers. In general, a passive market maker must display its bid at a price not in excess of the highest independent bid for such security; if all independent bids are lowered below the passive market maker’s bid, however, the passive market maker’s bid must then be lowered when certain purchase limits are exceeded.

To the extent required, this prospectus may be amended and supplemented from time to time to describe a specific plan of distribution.

DESCRIPTION OF COMMON STOCK

Our certificate of incorporation authorizes us to issue up to 75,000,000 shares of common stock, $0.001 par value. As of April 3, 2009, there were 54,019,324 shares of our common stock issued and outstanding.

The holders of shares of our common stock are entitled to one vote per share on all matters to be voted on by stockholders. Common stock holders are entitled to receive dividends declared by the board of directors out of funds legally available for the payment of dividends, subject to the rights, if any, of preferred stock holders. However, we have never paid a dividend and we do not anticipate paying a dividend in the foreseeable future. Our current secured credit facility prohibits us from paying cash dividends on our common stock. Upon any liquidation, dissolution or winding up of our business, the holders of common stock are entitled to share equally in all assets available for distribution after payment of all liabilities and provision for liquidation preference of shares of preferred stock then outstanding. The holders of common stock have no preemptive rights and no rights to convert their common stock into any other securities. There are no redemption or sinking fund provisions applicable to our common stock. All outstanding shares of common stock are fully paid and nonassessable.

Each share of our common stock includes an attached Right arising under and subject to the terms described in, the Rights Agreement, dated May 2, 2008 between us and Continental Stock Transfer & Trust Company, as rights agent. The terms of such Rights are summarized in “Rights Attaching to Our Common Stock” below.

The transfer agent and registrar for the common stock is Continental Stock Transfer & Trust Company 17 Battery Place, Floor 8, New York, New York 10004-1123.

RIGHTS ATTACHING TO OUR COMMON STOCK

On May 2, 2008, our Board of Directors declared a dividend distribution of one Right for each outstanding share of our common stock to our stockholders of record on May 12, 2008 (the "Record Date"). The Rights Agreement (as defined below) also contemplates the issuance of one Right for each share of common stock which is issued by the Company between the Record Date and the Distribution Date (or earlier redemption or termination of the Rights). The Rights are subject to the terms and conditions of the Rights Agreement, a copy of which is attached as Exhibit 4.1 to the Current Report on Form 8-K filed with the SEC on May 8, 2008. A copy of the Rights Agreement is also available upon written request to us. Because the following is a summary, the description below of the Rights and the Rights Agreement necessarily omits certain terms, exceptions, or qualifications to the statements made therein. You are advised to review the entire Rights Agreement prior to making any investment decision.

Each Right entitles the registered holder to purchase from us one one-hundredth of a share of our Series A Junior Participating Preferred Stock, par value $.001 per share (the "Preferred Shares") at a purchase price of $13.00 per one-one hundredth of a Preferred Share (the "Purchase Price"), subject to adjustment.

Until the earlier to occur of (a) 10 days following a public announcement that a person or group of affiliated or associated persons (an "Acquiring Person") have acquired beneficial ownership of 20% or more of our outstanding common stock (except pursuant to a Permitted Offer, as defined below, or persons excluded from being an Acquiring Person under the Rights Agreement) or (b) 10 business days (or such later date as may be determined by action of the Board of Directors prior to such time as any person becomes an Acquiring Person) following the commencement of, or announcement of an intention (which intention to commence remains in effect for 5 business days after such announcement) to make a tender offer or exchange offer, the consummation of which would result in a person or group becoming an Acquiring Person of 20% or more of our common stock (the earlier of such dates being called the "Distribution Date"), the Rights will be evidenced with respect to any of the common stock certificates outstanding and no separate Rights Certificates will be distributed.

Excluded from being an Acquiring Person under the Rights Agreement are the following (collectively, the "Excluded Persons"):

- the Company;
- any of our subsidiaries;
- any employee benefit plan of us or our subsidiaries;
- any entity holding common stock for or pursuant to the employee benefit plan o us or our subsidiaries;
- any Person who becomes the beneficial owner of 20% or more of the common stock solely as a result of the acquisition of common stock by us, unless such Person shall, after such share purchases by us, become the beneficial owner of additional shares of common stock constituting 1% or more of the then outstanding shares of common stock; and
- any person whom our Board of Directors determines in good-faith has acquired 20% or more of the common stock inadvertently and such person divests, within 10 business days after such determination, a sufficient number of shares of common stock to no longer beneficially own 20% of the common stock.

The Rights Agreement provides that, until the Distribution Date (or earlier redemption or expiration of the Rights):

- the Rights will be transferred with and only with our common stock;
- new common stock certificates issued after the Record Date, upon transfer or new issuance of common stock by us will contain a notation incorporating the Rights Agreement by reference; and
- the surrender for transfer of any certificates for common stock, even without such notation (or a copy of a summary of rights) being attached thereto, will also constitute the transfer of Rights associated with the common stock represented by such certificate.

As soon as practicable following the Distribution Date, separate certificates evidencing the Rights ("Right Certificates") will be mailed to the holders of record of the common stock as of the close of business on the Distribution Date and such separate Right Certificates alone will evidence the Rights.

The Rights are not exercisable until the Distribution Date. The Rights will expire on May 2, 2018 (the "Final Expiration Date"), unless the Final Expiration Date is extended or unless the Rights are earlier redeemed by us, in each case, as described below.

In the event that any person becomes an Acquiring Person (except pursuant to a tender or exchange offer which is for all outstanding shares of common stock at a price and on terms which a majority of certain members of the Board of Directors determines to be adequate and in our best interests, our stockholders and other relevant constituencies, other than the Acquiring Person, its affiliates and associates (a “Permitted Offer”)), each holder of a Right (except Rights which have been voided as set forth below) will thereafter have the right (the “Flip-In Rights”) to receive upon exercise the number of shares of common stock or of one-one hundredths of a share of Preferred Shares (or, in certain circumstances, other of our securities) having a value (on the date such person became an Acquiring Person) equal to two times the Purchase Price of the Right.

In the event that at any time (a) we are acquired in a merger or other business combination transaction in which we are not the survivor, (b) a merger or other business combination with us in which we are the survivor and, in connection with such transaction, all or part of the shares of common stock shall be changed for stock or other securities of any other person (or us) or (c) more than 50% of our assets or earning power is sold or transferred, then each holder of a Right (except Rights which have been voided as set forth below) shall thereafter have the right (the “Flip-Over Right”) to receive, upon exercise, common stock of the acquiring company having a value equal to two times the Purchase Price of the Right. The Flip-Over Right is not applicable to transactions described in (a) and (b) of this paragraph if (i) such transaction is consummated with a person who acquired common stock pursuant to a Permitted Offer; (ii) the price per share of common stock offered in such transaction is not less than the price per share of common stock paid to all holders of common stock purchased pursuant to the Permitted Offer, and (iii) the form of consideration offered in such transaction is the same as the form of consideration paid pursuant to the Permitted Offer.

The Purchase Price payable, and the number of Preferred Shares, common stock or other securities or property issuable, upon exercise of the Rights are subject to adjustment from time to time to prevent dilution:

- in the event of a stock dividend on, or a subdivision, combination or reclassification of, the Preferred Shares;
- upon the grant to holders of the Preferred Shares of certain rights or warrants to subscribed for or purchase Preferred Shares at a price, or securities convertible into Preferred Shares with a conversion price, less than the then current market price of the Preferred Shares; or
- upon the distribution to holders of the Preferred Shares of evidences of indebtedness or assets (excluding regular periodic cash dividends paid out of earnings or retained earnings or dividends payable in Preferred Shares) or of subscription rights or warrants (other than those referred to above).

The number of outstanding Rights and the number of one one-hundredths of a Preferred Share issuable upon exercise of each Right are also subject to adjustment in the event of a stock split of the common stock or a stock dividend on the common stock payable in common stock or subdivisions, consolidations or combinations of the common stock occurring, in any such case, prior to the Distribution Date.

Any Rights that are beneficially owned by (a) any Acquiring Person (or any affiliate or associate of such Acquiring Person), (b) a transferee of an Acquiring Person (or any affiliate or associate thereof) who becomes a transferee after the Acquiring Person becomes such, or (c) under certain conditions, a transferee of any Acquiring Person (or any affiliate or associate thereof) who becomes a transferee prior to or concurrently with the Acquiring Person becoming such, shall be null and void and no holder of such Rights shall thereafter have rights to exercise such Rights.

At any time after a person becomes an Acquiring Person and prior to the acquisition by such Person (or affiliate or associate of an Acquiring Person) of 50% or more of the outstanding common stock, our Board of Directors may exchange the Rights (other than Rights owned by such Acquiring Person which have become void), in whole or in part, at an exchange ratio of one share of common stock, or one-one hundredth of a Preferred Share (or of a share of a class or series of the our preferred stock having equivalent rights, preferences and privileges), per Right (subject to adjustment). Upon our Board of Directors ordering the exchange, the right to exercise the Right shall terminate and the only right thereafter shall be to receive the shares in accordance with the exchange.

With certain exceptions, no adjustment in the Purchase Price will be required until cumulative adjustments require an adjustment of at least 1% in such Purchase Price. No fractional Preferred Shares will be issued (other than fractions which are integral multiples of one one-hundredth of a Preferred Share, which may, at the election of the Company, be evidenced by depositary receipts) and in lieu thereof, an adjustment in cash will be made based on the market price of the Preferred Shares on the last trading day prior to the date of exercise.

At any time prior to the earlier of the Distribution Date or Final Expiration Date, our Board of Directors may redeem the Rights in whole, but not in part, at a price of $0.001 per Right (the “Redemption Price”), adjusted to reflect any stock split, stock dividend or similar transaction, and payable, at our option, either in cash, shares of common stock, or any other form of consideration deemed appropriate by our Board. The redemption of the rights may be made effective at such time, on such basis and with such conditions as the Board of Directors in its sole discretion may establish. Immediately upon any redemption of the Rights, the right to exercise the Rights will terminate and the only right of the holder of Rights will be to receive the Redemption Price.

The terms of the Rights Agreement and the Rights may be amended by us without the consent of the holders of the Rights, in order to cure any ambiguity, to correct or supplement any provision contained therein which may be defective or inconsistent with any other provisions contained therein, or to make any other changes or amendments to the provisions contained therein which the Company may deem necessary or desirable, except that from and after such time as any person becomes an Acquiring Person no such amendment may adversely affect the interests of the holders of the Rights (other than the Acquiring Person or any affiliate or associate of the Acquiring Person). No amendment to the Rights Agreement or the Rights shall be made which changes the redemption price or the number of Preferred Shares or shares of common stock for which a Right is exercisable or exchangeable.

Until a Right is exercised, the holder thereof, as such, will have no rights as a stockholder of the Company, including, without limitation, the right to vote or to receive dividends.

This summary description of the Rights does not purport to be complete and is qualified in its entirety by reference to the Rights Agreement.

LEGAL OPINION

Conner & Winters, LLP, Oklahoma City, Oklahoma will opine as to the validity of the issuance of the securities offered by this prospectus.

EXPERTS

The consolidated financial statements and financial statement schedules as of December 31, 2008 and 2007 and for each of the three years in the period ended December 31, 2008, and management’s assessment of the effectiveness of internal control over financial reporting as of December 31, 2008, incorporated by reference in this Registration Statement have been so incorporated in reliance on the reports of BDO Seidman, LLP, an independent registered public accounting firm (the report on the effectiveness of internal control over financial reporting expresses an adverse opinion on the effectiveness of the Company’s internal control over financial reporting as of December 31, 2008), incorporated herein by reference, given on the authority of said firm as experts in auditing and accounting.

WHERE YOU CAN FIND MORE INFORMATION

We file reports, proxy statements and other information with the Securities and Exchange Commission, in accordance with the Securities Exchange Act of 1934, or Exchange Act. You may read and copy any materials that we file with the Securities and Exchange Commission at the following address:

Public Reference Room
100 F Street, N.E.
Washington, D.C. 20549
1-800-SEC-0330

Please call the SEC at 1-800-SEC-0330 for further information about the public reference rooms. Our reports, proxy statements and other information filed with the SEC are available to the public over the Internet at the SEC's World Wide Web site at http://www.sec.gov. Our SEC file number for filings made under the Exchange Act is 001-11596.

INCORPORATION BY REFERENCE

The SEC allows us to "incorporate by reference" the information contained in documents that we file with the SEC, which means that we can disclose important information to you by referring you to those other documents. The information incorporated by reference is considered to be a part of this prospectus, and information that we file later with the SEC will automatically update and supersede this information. Therefore, before you decide to invest in a particular offering under this shelf-registration, you should always check for reports we may have filed with the SEC after the data of this prospectus.

We incorporate by reference the documents listed below:

- Annual Report on Form 10-K for the fiscal year ended December 31, 2008, filed March 31, 2009;
- Quarterly Report on Form 10-Q for the fiscal quarter ended March 31, 2009, filed May 11, 2009;
- Current Reports on Form 8-K filed with the Securities and Exchange Commission on March 2, 2009, March 11, 2009, March 30, 2009, April 8, 2009, and May 7, 2009 (two reports);
- The description of our Series A Junior Participating Preferred Stock, par value $.001 per share, that is contained in the Form 8-A Registration Statement, filed on May 13, 2008, as amended October 2, 2008, including any amendments or reports filed for the purpose of updating such description.
- The description of the common stock of the Registrant that is contained in the Registration Statement on Form 8-A filed pursuant to Section 12 of the Exchange Act that became effective on October 30, 1992, including any amendments or reports filed for the purpose of updating such description.

Also incorporated by reference into this prospectus are all documents that we may file with the SEC under Sections 13(a), 13(c), 14 or 15(d) of the Exchange Act after the date of this prospectus and before we stop offering the securities described in this prospectus. These documents include periodic reports, such as annual reports on Form 10-K, quarterly reports on Form 10-Q and current reports on Form 8-K, as well as proxy statements. Any statement contained herein or in a document incorporated or deemed to be incorporated by reference herein shall be deemed to be modified or superseded for purposes of this prospectus to the extent that a statement contained herein or in any other subsequently filed document which also is or is deemed to be incorporated by reference herein modifies or supersedes such statement. Any such statement so modified or superseded shall not be deemed to constitute a part of this prospectus, except as so modified or superseded.

We will provide to each person who so requests, including any beneficial owner to whom a prospectus is delivered, a copy of these filings excluding exhibits except to the extent such exhibits are specifically incorporated by reference. You may request a copy of these filings, at no cost, by writing or telephoning us at the following address:

Perma-Fix Environmental Services, Inc.
Attention: Chief Financial Officer
8302 Dunwoody Place, #250
Atlanta, Georgia 30350
(770) 587-9898

You should rely only on the information incorporated by reference or provided in this prospectus or any prospectus supplement. We have not authorized anyone else to provide you with different information. We are not making an offer of these securities in any state where the offer is not permitted. You should not assume the information in this prospectus or any prospectus supplement is accurate as of any date other than the date on the front of those documents.

PART II
INFORMATION NOT REQUIRED IN PROSPECTUS

Item 14. Other Expenses of Issuance and Distribution

The aggregate estimated (other than the registration fee) expenses to be paid by the Registrant in connection with this offering are as follows:

SEC Registration Fee	$	381
Legal Fees (Including Blue Sky)	$	55,000
Accounting Fees and Expenses	$	10,000
Printing	$	2,500
Miscellaneous	$	500
Total:	$	68,381

The foregoing expenses, except for the registration fee, are estimated pursuant to Item 511 of Regulation S-K.

Item 15. Indemnification of Officers and Directors

Section 145 of the Delaware Corporation Law provides that a corporation has the power to indemnify a director, officer, employee or agent of the corporation and certain other persons serving at the request of the corporation in related capacities against amounts paid and expenses incurred in connection with an action or proceeding to which he is or is threatened to be made a party by reason of such position, if such person shall have acted in good faith and in a manner he reasonably believed to be in or not opposed to the best interests of the corporation, and, in any criminal proceeding, if such person had no reasonable cause to believe his conduct was unlawful; provided that, no indemnification shall be made with respect to any matter as to which such person shall have been adjudged to be liable to the corporation unless and only to the extent that the adjudicating court determines that, despite the adjudication of liability but in view of all the circumstance of the case, such person is fairly and reasonably entitled to indemnification.

Article EIGHTH of our Restated Certificate of Incorporation, as amended, provides as follows with respect to the indemnification of our officers and directors:

All persons who the Corporation is empowered to indemnify pursuant to the provisions of Section 145 of the General Corporation Law of the State of Delaware (or any similar provision or provisions of applicable law at the time in effect), shall be indemnified by the Corporation to the full extent permitted thereby. The foregoing right of indemnification shall not be deemed to be exclusive of any other rights to which those seeking indemnification may be entitled under any bylaw, agreement, vote of stockholders or disinterested directors, or otherwise. No repeal or amendment of this Article EIGHTH shall adversely affect any rights of any person pursuant to this Article EIGHTH which existed at the time of such repeal or amendment with respect to acts or omissions occurring prior to such repeal or amendment.

Our Restated Certificate of Incorporation, as amended, provides that no director shall be personally liable to us or its stockholders for any monetary damages for breaches of fiduciary duty as a director, provided that this provision shall not eliminate or limit the liability of a director (i) for any breach of the director's duty of loyalty to us or our stockholders; (ii) for acts or omissions not in good faith or which involve intentional misconduct or a knowing violation of law; (iii) under Section 174 of the General Corporation Law of the State of Delaware; or (iv) for any transaction from which the director derived an improper personal benefit.

ng-top:2px;padding-bottom:2px;">
Common Stock

Additional
Paid-in
Capital

Retained
Earnings

Accumulated
Other
Comprehensive
Income

Treasury Stock

Shares

Amount

Shares

Amount

Shares

Amount

Non-Controlling Interest

Total
Balance at December 31, 2012
418

$
4

72,264

$
723

$
204,510

$
113,831

$
14,770

(1,267
)

$
(14,848
)

$
2,718

$
321,708

Acquisition of treasury stock
—

—

—

—

—

—

—

(56
)

(364
)

—

(364
)
Issuance of treasury stock
—

—

—

—

(1,649
)

—

—

140

1,649

—

—

Preferred stock to common stock exchange
(234)

(2
)

3,317

33

(31
)

—

—

—

—

—

—

Equity issuance costs
—

—

—

—

(274
)

—

—

—

—

—

(274
)
Compensatory stock and stock options
—

—

56

—

2,592

—

—

—

—

—

2,592

Stock dividends
—

—

75

1

566

(567
)

—

—

—

—

—

Cash dividends
—

—

—

—

—

(4,882
)

—

—

—

—

(4,882
)
Equity adjustment from foreign currency translation
—

—

—

—

—

—

(11,886
)

—

—

—

(11,886
)
Changes in non-controlling interest
—

—

—

—

—

—

—

—

—

(2,718
)

(2,718
)
Net income
—

—

—

—

—

30,578

—

—

—

—

30,578

Balance at September 30, 2013

184

$
2

75,712

$
757

$
205,714

$
138,960

$
2,884

(1,183
)

$
(13,563
)

$
—

$
334,754

The accompanying notes are an integral part of these financial statements.

CALLAWAY GOLF COMPANY
NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS
(Unaudited)
Note 1. Basis of Presentation
The accompanying unaudited consolidated condensed financial statements have been prepared by Callaway Golf Company (the “Company” or “Callaway Golf”) pursuant to the rules and regulations of the Securities and Exchange Commission (“SEC”). Accordingly, certain information and disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States (“U.S. GAAP”) have been condensed or omitted. These consolidated condensed financial statements should be read in conjunction with the consolidated financial statements and notes thereto included in the Company’s Annual Report on Form 10-K for the year ended December 31, 2012 filed with the SEC. These consolidated condensed financial statements, in the opinion of management, include all adjustments necessary for the fair presentation of the financial position, results of operations and cash flows for the periods and dates presented. Interim operating results are not necessarily indicative of operating results for the full year.
The preparation of financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ materially from those estimates and assumptions.
Recent Accounting Standards
The Financial Accounting Standards Board (“FASB”) issued Accounting Standards Update (“ASU”) No. 2013-05, “Foreign Currency Matters (Topic 830): Parent’s Accounting for the Cumulative Translation Adjustment upon Derecognition of Certain Subsidiaries or Groups of Assets within a Foreign Entity or of an Investment in a Foreign Entity.” This ASU provides guidance on releasing cumulative translation adjustments to net income when an entity ceases to have a controlling financial interest in a subsidiary or business within a foreign entity. The cumulative translation adjustments should be released only if the sale or transfer results in the complete or substantially complete liquidation of the foreign entity in which the subsidiary or group of assets resides. This ASU is effective on a prospective basis for fiscal years and interim reporting periods within those years, beginning after December 15, 2013. The Company is currently evaluating the impact this ASU will have on its consolidated condensed financial statements.
In December 2011, the FASB issued ASU No. 2011-11, “Balance Sheet (Topic 210): Disclosures about Offsetting Assets and Liabilities.” This ASU requires an entity to disclose information about offsetting and related arrangements to enable users of its financial statements to understand the effect of those arrangements on its financial position. ASU No. 2011-11 is effective for annual and interim reporting periods beginning on or after January 1, 2013 on a retrospective basis. The adoption of this ASU did not have a material impact on the Company’s disclosures to the consolidated condensed financial statements.

Note 2. Cost Reduction Initiatives
In July 2012, the Company implemented its cost-reduction initiatives (the “Cost Reduction Initiatives”) in order to streamline and simplify the Company’s organizational structure and change the manner in which the Company approaches and operates its business. In the aggregate through September 30, 2013, the Company recognized total charges of $64,426,000 in connection with these initiatives, of which approximately two-thirds resulted in non-cash charges. In connection with Cost Reduction Initiatives, the Company expects to incur total pre-tax charges of approximately $68,000,000, and expects to realize total savings of approximately $60,000,000. The Company expects to incur estimated future charges of approximately $3,000,000 over the next three months. These estimates are based upon current information and expectations, however, the amount, nature, or timing of these charges could vary as the Company further develops and implements these initiatives.
During the three and nine months ended September 30, 2013, the Company recognized charges of $1,858,000 and $10,365,000 in connection with the Cost Reduction Initiatives. Amounts recognized in cost of sales during the three and nine months ended September 30, 2013 totaled $1,005,000 and $7,374,000, respectively, and amounts recognized in operating expenses totaled $853,000 and $2,991,000, respectively. During the three and nine months ended

September 30, 2012, the Company recognized charges of $35,084,000 and $39,755,000 in connection with these initiatives. Amounts recognized in cost of sales during the three and nine months ended September 30, 2012 totaled $27,302,000 and $28,263,000, respectively, and amounts recognized in operating expenses totaled $7,782,000 and $11,492,000, respectively. See Note 17 for charges recognized by the Company’s operating segments.

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CALLAWAY GOLF COMPANY
NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS - (Continued)
(Unaudited)

The table below summarizes the total charges recognized during 2013, the liability balances, and the estimated future charges relating to the Cost Reduction Initiatives (in thousands). Amounts payable as of September 30, 2013 and December 31, 2012 are included in accrued employee compensation and benefits and accounts payable and accrued expenses in the accompanying consolidated condensed balance sheets.

	Cost Reduction Initiatives			
	Workforce Reductions	Transition Costs	Asset Write-offs	Total
Restructuring payable balance, December 31, 2012	$4,531	$591	$—	$5,122
Charges to cost and expense	1,091	2,418	—	3,509
Non-cash items	—	(1,699)	—	(1,699)
Cash payments	(3,547)	(717)	—	(4,264)
Restructuring payable balance, March 31, 2013	$2,075	$593	$—	$2,668
Charges to cost and expense	677	997	3,324	4,998
Non-cash items	—	(412)	(3,324)	(3,736)
Cash payments	(1,652)	(1,071)	—	(2,723)
Restructuring payable balance, June 30, 2013	$1,100	$107	$—	$1,207
Charges to cost and expense	602	1,256	—	1,858
Non-cash items	—	(675)	—	(675)
Cash payments	(669)	(45)	—	(714)
Restructuring payable balance, September 30, 2013	$1,033	$643	$—	$1,676
Total future estimated charges as of September 30, 2013	$700	$2,300	$—	$3,000

Note 3. Financing Arrangements

In addition to cash on hand, as well as cash generated from operations, the Company relies on its asset-based revolving credit facility to manage seasonal fluctuations in liquidity and to provide additional liquidity when the Company's operating cash flows are not sufficient to fund the Company's requirements. The Company's ability to generate sufficient positive cash flows from operations is subject to many risks and uncertainties, including future economic trends and conditions, the success of the Company's multi-year turnaround, demand for the Company's products, foreign currency exchange rates, and the other risks and uncertainties applicable to the Company and its business. If the Company is unable to generate sufficient cash flows to fund its business due to a decline in sales or otherwise and is unable to reduce its manufacturing costs and operating expenses to offset such decline, the Company will need to increase its reliance on its credit facility for needed liquidity. If the Company's current credit facility is not available or sufficient and the Company could not secure alternative financing arrangements, the Company's future operations would be significantly, adversely affected. The Company believes that its current credit facility, along with its cash on hand and cash flows expected to be generated from operations, is sufficient to meet the Company's liquidity requirements for at least the next 12 months.

Asset-Based Revolving Credit Facility

The Company has a Loan and Security Agreement with Bank of America N.A. (as amended, the "ABL Facility") which provides a senior secured asset-based revolving credit facility of up to $230,000,000, comprised of a $158,333,000 U.S. facility, a $31,667,000 Canadian facility, and a $40,000,000 United Kingdom facility, in each case subject to borrowing base availability under the applicable facility. The aggregate amount outstanding under the Company's letters of credit was $1,278,000 at September 30, 2013. The amounts outstanding under the ABL Facility are secured by certain assets, including cash (to the extent pledged by the Company), inventory and accounts receivable, of the Company's U.S., Canadian and U.K. legal entities.

As of September 30, 2013, the Company had no borrowings outstanding under the ABL Facility and had $37,399,000 of cash and cash equivalents. As of September 30, 2013, the Company could borrow $47,607,000 under the ABL Facility. The maximum availability under the ABL Facility fluctuates with the general seasonality of the business and increases and decreases with changes in the Company’s inventory and accounts receivable balances. The maximum availability is at its highest during the

CALLAWAY GOLF COMPANY
NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS - (Continued)
(Unaudited)

first half of the year when the Company's inventory and accounts receivable balances are high and then decreases during the second half of the year when the Company's accounts receivable balances are lower due to an increase in cash collections. Average outstanding borrowings during the nine months ended September 30, 2013 was $41,119,000 and average available liquidity, defined as cash on hand combined with amounts available under the ABL Facility after outstanding borrowings was $91,318,000. Amounts borrowed under the ABL Facility may be repaid and borrowed as needed. The entire outstanding principal amount (if any) is due and payable at maturity on June 30, 2016. The ABL Facility includes certain restrictions including, among other things, restrictions on incurrence of additional debt, liens, dividends, stock repurchases and other restricted payments, asset sales, investments, mergers, acquisitions and affiliate transactions. As of September 30, 2013, the Company was in compliance with all covenants of the ABL Facility. Additionally, the Company is subject to compliance with a fixed charge coverage ratio covenant during, and continuing 30 days after, any period in which the Company's borrowing base availability falls below $25,000,000. The Company would not have met the fixed charge coverage ratio as of September 30, 2013; however, the Company's borrowing base availability was above $25,000,000 during the nine months ended September 30, 2013, and as such the Company was not subject to compliance with the fixed charge coverage ratio.

The interest rate applicable to outstanding loans under the ABL Facility fluctuates depending on the Company's trailing twelve month EBITDA (as defined by the ABL Facility) combined with the Company's "availability ratio." The Company's "availability ratio" is expressed as a percentage of (a) the average daily availability under the ABL Facility to (b) the sum of the Canadian, the U.K. and the U.S. borrowing bases, as adjusted. All applicable margins may be permanently reduced by 0.25% if EBITDA meets or exceeds $25,000,000 over any trailing twelve month period, and may be permanently reduced by an additional 0.25% if EBITDA meets or exceeds $50,000,000 over any trailing twelve month period. At September 30, 2013, the Company's trailing twelve months average interest rate applicable to its outstanding loans under the ABL Facility was 6.20%.

In addition, the ABL Facility provides for monthly fees ranging from 0.375% to 0.5% of the unused portion of the ABL Facility, depending on the prior month's average daily balance of revolver loans and stated amount of letters of credit relative to lenders' commitments.

The origination fees incurred in connection with the ABL Facility totaled $4,292,000, which are being amortized into interest expense over the term of the ABL Facility agreement. Unamortized origination fees as of September 30, 2013 and December 31, 2012 were $2,515,000 and $3,171,000, respectively, of which $915,000 and $906,000, respectively, were included in other current assets, and $1,600,000 and $2,265,000 were included in other assets, respectively, in the accompanying consolidated condensed balance sheets.

Convertible Senior Notes

In August 2012, the Company issued $112,500,000 of 3.75% Convertible Senior Notes (the "convertible notes"). The convertible notes pay interest of 3.75% per year on the principal amount, payable semiannually in arrears on February 15 and August 15 of each year. The convertible notes mature on August 15, 2019.

The Company incurred transactional fees of $3,539,000, which are being amortized into interest expense over the term of the convertible notes. Unamortized transaction fees as of September 30, 2013 and December 31, 2012 were $2,992,000 and $3,365,000, respectively, of which $506,000 and $505,000 were included in other current assets, respectively, and $2,486,000 and $2,860,000 were included in other assets, respectively, in the accompanying consolidated condensed balance sheets.

The net carrying amount of the convertible notes as of September 30, 2013 and December 31, 2012 was $107,656,000 and $107,133,000, respectively. The unamortized discount of $4,844,000 as of September 30, 2013 will be amortized over the remaining term of approximately 5.9 years. Total interest and amortization expense recognized during the three and nine months ended September 30, 2013 was $1,234,000 and $3,673,000, respectively.

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CALLAWAY GOLF COMPANY
NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS - (Continued)
(Unaudited)

The notes are convertible, at the option of the note holder, at any time on or prior to the close of business on the business day immediately preceding August 15, 2019, into shares of common stock at an initial conversion rate of 133.3333 shares per $1,000 principal amount of convertible notes, which is equal to 15,000,000 shares of common stock at a conversion price of approximately $7.50 per share, subject to customary anti-dilution adjustments. Upon the occurrence of certain change of control events of the Company, the Company will pay a premium on the convertible notes converted in connection with such change of control events by increasing the conversion rate on such convertible notes.

Under certain circumstances, the Company has the right to terminate the right of note holders to convert their convertible notes. If the Company exercises such termination right prior to August 15, 2015, each note holder who converts its convertible notes after receiving notice of such exercise will receive a make-whole payment in cash or common stock, as the Company may elect, with respect to the convertible notes converted.

Upon the occurrence of a change of control of the Company or a termination of trading of the common stock of the Company, note holders will have the option to require the Company to repurchase for cash all or any portion of such note holder’s convertible notes at a price equal to 100% of the principal amount of the repurchased convertible notes, plus accrued and unpaid interest thereon to the repurchase date.

The convertible notes are not redeemable by the Company prior to August 15, 2015. On or after August 15, 2015, the convertible notes are redeemable in whole or in part at the option of the Company at a redemption price equal to 100% of the principal amount of the convertible notes to be redeemed, plus accrued and unpaid interest thereon to the redemption date.

The convertible notes contain certain covenants including payment of principal, certain repurchase obligations and interest, obligations of the Company to convert the convertible notes, and other customary terms as defined in the Indenture. The Company was in compliance with these covenants as of September 30, 2013.

Note 4. Preferred Stock

In August 2013, the Company exchanged 233,843 shares of its 7.50% Series B Cumulative Perpetual Convertible Preferred Stock, $0.01 par value, (the “preferred stock”) for 3,316,922 shares of the Company's common stock at the stated conversion rate plus an additional 75,342 shares as an inducement. The Company also paid the exchanging holders cash dividends through December 15, 2013 on their shares of Preferred Stock surrendered in the exchange. After the exchange, the company has 183,796 shares remaining of preferred stock outstanding. The preferred stock is generally convertible at any time at the holder’s option into common stock of the Company at an initial conversion rate of 14.1844 shares of Callaway’s common stock per share of preferred stock, which is equivalent to an initial conversion price of approximately $7.05 per share. At September 30, 2013, based on the initial conversion rate, approximately 2,607,000 shares of common stock would be issuable upon conversion of all of the remaining outstanding shares of preferred stock.

The terms of the preferred stock provide for a liquidation preference of $100 per share and cumulative unpaid dividends from the date of original issue at a rate of 7.50% per annum (equal to an annual rate of $7.50 per share), subject to adjustment in certain circumstances. As of September 30, 2013, the liquidation preference would have been $18,437,000. Dividends on the preferred stock are payable quarterly in arrears subject to declaration by the Board of Directors and compliance with the Company’s line of credit and applicable law.

The Company, at its option, may redeem the preferred stock subject to available liquidity and compliance with any applicable legal requirements and contractual obligations, in whole or in part, at a price equal to 100% of the liquidation preference, plus all accrued and unpaid dividends. The preferred stock has no maturity date and has no voting rights prior to conversion into the Company’s common stock, except in limited circumstances.

Note 5. Earnings per Common Share

Earnings per common share, basic, is computed by dividing net income allocable to common shareholders (net income less preferred stock dividends) by the weighted-average number of common shares outstanding for the period.

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CALLAWAY GOLF COMPANY
NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS - (Continued)
(Unaudited)

Earnings per common share, diluted, is computed by dividing net income allocable to common shareholders, adjusted for preferred stock dividends and the interest on the Company's convertible notes, by the weighted-average number of common shares – diluted. Dilutive securities are included in the calculation of diluted earnings per common share using the treasury stock method and the if-converted method in accordance with Accounting Standards Codification (“ASC”) Topic 260, “Earnings per Share.” Dilutive securities include the common stock equivalents of convertible preferred stock and convertible notes, options granted pursuant to the Company’s stock option plans and outstanding restricted stock units granted to employees and non-employee directors (Note 14).

Weighted-average common shares outstanding—diluted is the same as weighted-average common shares outstanding—basic in periods when a net loss is reported or in periods when diluted earnings per share is higher than basic earnings per share.

The following table summarizes the computation of basic and diluted earnings per share (in thousands, except per share data):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2013	2012	2013	2012
Earnings (loss) per common share—basic				
Net income (loss)	$(21,153)	$(86,798)	$30,578	$(52,197)
Less: Preferred stock dividends	1,766	2,414	3,332	7,664
Net income (loss) allocable to common shareholders	$(22,919)	$(89,212)	$27,246	$(59,861)
Weighted-average common shares outstanding—basic	72,649	67,162	71,613	65,740
Basic earnings (loss) per common share	$(0.32)	$(1.33)	$0.38	$(0.91)
Earnings (loss) per common share—diluted				
Net income (loss)	(21,153)	$(86,798)	$30,578	$(52,197)
Less: Preferred stock dividends	1,766	2,414	3,332	7,664
Add: Interest on convertible debt, net of tax	—	—	3,673	—
Net income (loss) including assumed conversions	$(22,919)	$(89,212)	$30,919	$(59,861)
Weighted-average common shares outstanding—basic	72,649	67,162	71,613	65,740
Convertible notes weighted-average shares outstanding	—	—	15,000	—
Options and restricted stock	—	—	257	—
Weighted-average common shares outstanding—diluted	72,649	67,162	86,870	65,740
Dilutive earnings (loss) per common share	$(0.32)	$(1.33)	$0.36	$(0.91)

Securities that resulted in an anti-dilutive effect were excluded from the earnings per share computation as follows: For the three months ended September 30, 2013 and 2012, securities outstanding totaling approximately 24,716,000 and 26,135,000 shares, respectively, including common shares underlying preferred stock of 4,446,000 and 14,958,000, respectively, common shares underlying convertible senior notes of 15,000,000 and 5,275,000, respectively, in addition to antidilutive options and restricted stock. For the nine months ended September 30, 2013 and 2012, securities outstanding totaling approximately 11,117,000 and 28,222,000 shares, respectively, including common shares underlying preferred stock of 5,426,000 and 18,225,000, respectively, antidilutive options and restricted stock, and common shares underlying convertible senior notes of 1,758,000 for the nine months ended September 30, 2012.

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CALLAWAY GOLF COMPANY
NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS - (Continued)
(Unaudited)

Note 6. Sale of Buildings
On February 28, 2013, the Company completed the sale of its manufacturing facility in Chicopee, Massachusetts for proceeds of $3,496,000, net of closing costs and commissions. The Company had marked the building down to its estimated selling price, net of commissions, fees and estimated environmental remediation costs in 2012 and recorded a loss on the sale of $31,000 during the first quarter of 2013. The Company has $1,035,000 and $1,243,000 accrued in accounts payable and accrued expenses as of September 30, 2013 and December 31, 2012, respectively, for certain environmental remediation costs related to the sale of this facility. The Company has leased back a reduced portion of the square footage that it believes is adequate for ongoing golf ball operations.

Note 7. Inventories
Inventories are summarized below (in thousands):

	September 30, 2013	December 31, 2012
Inventories:		
Raw materials	$ 41,600	$ 43,469
Work-in-process	478	619
Finished goods	148,792	167,646
	$ 190,870	$ 211,734

Note 8. Goodwill and Intangibles Assets
In accordance with ASC Topic 350, “Intangibles—Goodwill and Other,” the Company’s goodwill and certain intangible assets are not amortized, but are subject to an annual impairment test. The Company performs an impairment analysis on its goodwill and intangible assets at least annually and whenever events or changes in circumstances indicate that the carrying value of such assets may not be fully recoverable.
The following sets forth the intangible assets by major asset class (dollars in thousands):

	Useful Life (Years)	September 30, 2013			December 31, 2012		
		Gross	Accumulated Amortization	Net Book Value	Gross	Accumulated Amortization	Net Book Value
Non-Amortizing:							
Trade name, trademark and trade dress and other	NA	$88,590	$ —	$88,590	$88,590	$ —	$88,590
Amortizing:							
Patents	2-16	31,581	31,272	309	31,581	31,022	559
Developed technology and other	1-9	7,961	7,938	23	7,961	7,921	40
Total intangible assets		$128,132	$ 39,210	$88,922	$128,132	$ 38,943	$89,189

Aggregate amortization expense on intangible assets was approximately $267,000 and $2,645,000 for the nine months ended September 30, 2013 and 2012, respectively.

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CALLAWAY GOLF COMPANY
NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS - (Continued)
(Unaudited)

Amortization expense related to intangible assets at September 30, 2013 in each of the next five fiscal years and beyond is expected to be incurred as follows (in thousands):

Remainder of 2013	$21
2014	68
2015	51
2016	51
2017	51
2018	51
Thereafter	39
	$332

Goodwill at September 30, 2013 and December 31, 2012 was $29,060,000 and $29,034,000, respectively. The increase in goodwill during the nine months ended September 30, 2013 of $26,000 was due to foreign currency fluctuations. Gross goodwill before impairments at September 30, 2013 and December 31, 2012 was $30,809,000 and $30,783,000, respectively.

Note 9. Investments

Investment in TopGolf International, Inc.

The Company owns preferred shares of TopGolf International, Inc. (“TopGolf”), the owner and operator of TopGolf entertainment centers. In connection with this investment, the Company has a preferred partner agreement with TopGolf in which the Company has preferred signage rights, rights as the preferred supplier of golf products used or offered for use at TopGolf facilities at prices no less than those paid by the Company’s customers, preferred retail positioning in the TopGolf retail stores, access to consumer information obtained by TopGolf, and other rights incidental to those listed.

During the three and nine months ended September 30, 2013, the Company invested an additional $5,709,000 and $7,189,000, respectively, in preferred shares of TopGolf, thereby increasing the Company's total investment as of September 30, 2013 to $31,156,000. The Company’s total ownership interest in TopGolf, including the incremental investments completed in 2013, is less than 20%. In addition, the Company does not have the ability to significantly influence the operating and financing activities and policies of TopGolf. Accordingly, the Company’s investment in TopGolf is accounted for at cost in accordance with ASC Topic 325, “Investments—Other,” and is included in other assets in the accompanying consolidated condensed balance sheets as of September 30, 2013 and December 31, 2012.

Note 10. Non Controlling Interests

Investment in Qingdao Suntech Sporting Goods Limited Company

Through June 30, 2013, the Company had a Golf Ball Manufacturing and Supply Agreement with Qingdao Suntech Sporting Goods Limited Company (“Suntech”), in which Suntech manufactured and supplied certain golf balls solely for and to the Company. In connection with the agreement, the Company provided Suntech with golf ball raw materials, packing materials, molds, tooling, as well as manufacturing equipment in order to carry out the manufacturing and supply obligations set forth in the agreement. Suntech provided the personnel as well as the facilities to effectively perform these manufacturing and supply obligations.

In July 2013, the Company terminated the Golf Ball Manufacturing and Supply Agreement and certain ancillary agreements with Suntech, and as a result, during the three and nine months ended September 30, 2013, the Company recognized charges of $303,000 and $3,738,000, respectively, the majority of which was related to the write-off of certain manufacturing equipment and inventory located at the Suntech manufacturing facility. These charges were recognized in cost of sales within the Company's golf balls operating segment. Additionally, as a result of the termination of the Golf Ball Manufacturing and Supply Agreement, the Company no longer has a controlling influence over the Suntech operations and therefore no longer consolidates the financial results of Suntech in it's consolidated financial statements in accordance with ASC Topic 810, “Consolidations.”

Suntech is a wholly-owned subsidiary of Suntech Mauritius Limited Company (“Mauritius”). The Company had previously entered into a loan agreement with Mauritius in order to provide working capital for Suntech. In connection with this loan agreement, the Company loaned Mauritius a total of $3,200,000, of which $1,588,000 and $1,788,000 was outstanding at September 30, 2013 and December 31, 2012, respectively. The termination of the Golf Ball Manufacturing and Supply Agreement did not affect the terms of the loan. The loan is included in other assets in the accompanying consolidated condensed balance sheets as of September 30, 2013 and December 31, 2012.

CALLAWAY GOLF COMPANY

NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS - (Continued)

(Unaudited)

Note 11. Product Warranty

The Company has a stated two-year warranty policy for its golf clubs, although the Company sometimes honors warranty claims after the two-year stated warranty period at the Company's discretion. The Company's policy is to accrue the estimated cost of satisfying future warranty claims at the time the sale is recorded. In estimating its future warranty obligations, the Company considers various relevant factors, including the Company's stated warranty policies and practices, the historical frequency of claims, and the cost to replace or repair its products under warranty. The decrease in the future estimated warranty obligation is primarily due to an overall decrease in product returns combined with a decline in the cost to replace older product.

The following table provides a reconciliation of the activity related to the Company's reserve for warranty expense (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2013	2012	2013	2012
Beginning balance	$8,241	$7,863	$7,539	$8,140
Provision	190	2,832	4,335	6,605
Claims paid/costs incurred	(1,665)	(2,562)	(5,108)	(6,612)
Ending balance	$6,766	$8,133	$6,766	$8,133

Note 12. Income Taxes

The Company calculates its interim income tax provision in accordance with ASC 270, "Interim Reporting," and ASC 740 "Accounting for Income Taxes" (together, "ASC 740"). In general, at the end of each interim period, the Company estimates the annual effective tax rate for foreign operations and applies that rate to its ordinary foreign quarterly earnings. For the nine months ended September 30, 2013 and consistent with prior quarters, the discrete method was used to calculate the Company's U.S. interim tax expense as the annual effective rate was not considered a reliable estimate of year-to-date income tax expense. Under the discrete method, the Company determines its U.S. tax expense based upon actual results as if the interim period were an annual period. The Company's full U.S. valuation allowance position and the seasonality of the Company's business create results with significant variations in the customary relationship between income tax expense and pre-tax income for the interim periods. As a result, the use of the discrete method is more appropriate than the annual effective tax rate method.

The realization of deferred tax assets, including loss and credit carry forwards, is subject to the Company generating sufficient taxable income during the periods in which the temporary differences become realizable. Due to the Company's taxable losses in the United States over the last few years, the Company has recorded a valuation allowance against its U.S. deferred tax assets. At each quarter end that a valuation allowance is maintained, as the U.S. deferred tax assets are adjusted upwards or downwards, the associated valuation allowance and income tax expense will be adjusted. If sufficient positive evidence arises in the future, such as a sustained return to profitability in the U.S. business, any existing valuation allowance could be reversed as appropriate, decreasing income tax expense in the period that such conclusion is reached.

The provision for income taxes is primarily comprised of taxes related to the Company's foreign operations. The income tax provision for the third quarter of 2013 and 2012 was $1,037,000 and $750,000, respectively. This increase was primarily due to the release of certain unrecognized tax benefit liabilities in the third quarter of 2012 due to the lapse of statutes of limitation. The provision for income taxes for the nine months ended September 30, 2013 and 2012 was $4,941,000 and $2,654,000, respectively. This increase resulted primarily from the sale of indefinite lived assets relating to the Top-Flite and Ben Hogan brands in the first quarter of 2012.

At September 30, 2013, the liability for income taxes associated with uncertain tax positions was $8,484,000. This amount could be reduced by $2,798,000 of offsetting tax benefits associated with the correlative effects of potential transfer pricing adjustments as well as $3,063,000 of deferred taxes. The net amount of $2,623,000, if recognized, would favorably affect the Company's consolidated condensed financial statements and effective income tax rate. The unrecognized tax benefit liabilities are expected to decrease approximately $1,904,000 during the next 12 months.

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The Company recognizes interest and/or penalties related to income tax matters in income tax expense. For the three months ended September 30, 2013 and 2012, the Company's provision for income taxes includes charges of $58,000 and a benefit of $61,000, respectively, related to interest and penalties. For the nine months ended September 30, 2013 and 2012, the Company's provision for income taxes includes a benefit of $150,000 and charges of $29,000, respectively, related to interest and penalties. As of September 30, 2013 and December 31, 2012, the gross amount of accrued interest and penalties included in income taxes payable in the accompanying consolidated condensed balance sheets was $920,000 and $1,245,000, respectively.

The Company or one of its subsidiaries files income tax returns in the U.S. federal jurisdiction and various states and foreign jurisdictions. The Company is generally no longer subject to income tax examinations by tax authorities in the following major jurisdictions:

Tax Jurisdiction	Years No Longer Subject to Audit
U.S. federal	2008 and prior
California (United States)	2007 and prior
Canada	2005 and prior
Japan	2006 and prior
South Korea	2008 and prior
United Kingdom	2008 and prior

Pursuant to Section 382 of the Internal Revenue Code, use of the Company's NOL and credit carry-forwards may be limited significantly if the Company were to experience a cumulative change in ownership of the Company's stock by “5-percent shareholders” that exceeds 50% over a rolling three-year period. The Company does not believe there has been a cumulative change in ownership in excess of 50% during that period. The Company continues to monitor changes in ownership. If such a cumulative change did occur in any three year period and the Company was limited in the amount of losses it could use to offset taxable income, the Company's results of operations and cash flows would be adversely impacted.

Note 13. Commitments & Contingencies

Legal Matters

The Company is subject to routine legal claims, proceedings, and investigations incident to its business activities, including claims, proceedings, and investigations relating to commercial disputes and employment matters. The Company also receives from time to time information claiming that products sold by the Company infringe or may infringe patent, trademark, or other intellectual property rights of third parties. One or more such claims of potential infringement could lead to litigation, the need to obtain licenses, the need to alter a product to avoid infringement, a settlement or judgment, or some other action or material loss by the Company, which also could adversely affect the Company’s overall ability to protect its product designs and ultimately limit its future success in the marketplace. In addition, the Company is occasionally subject to non-routine claims, proceedings, or investigations.

The Company regularly assesses such matters to determine the degree of probability that the Company will incur a material loss as a result of such matters as well as the range of possible loss. An estimated loss contingency is accrued in the Company’s financial statements if it is probable the Company will incur a loss and the amount of the loss can be reasonably estimated. The Company reviews all claims, proceedings, and investigations at least quarterly and establishes or adjusts any accruals for such matters to reflect the impact of negotiations, settlements, advice of legal counsel, and other information and events pertaining to a particular matter. All legal costs associated with such matters are expensed as incurred.

Set forth is a description of certain litigation to which the Company is a party:

Cleveland Golf Litigation. On October 18, 2013, Dunlop Sports Co., Ltd., a Japanese Corporation, and its wholly-owned subsidiary, Roger Cleveland Golf Company, Inc., which sells golf equipment under the Cleveland and Cleveland Golf trademarks (“Cleveland Golf”), filed a complaint against Callaway Golf Company in the United States

District Court - Central District of California (Case 8:13-cv-01642). The Complaint alleges that Callaway's use on its Callaway branded Mack Daddy 2 Wedges of

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the phrase “Designed by Roger Cleveland” constitutes trademark infringement (and related claims) of Cleveland Golf’s “Cleveland” trademark. The plaintiffs are seeking unspecified damages, including punitive damages, costs and attorneys’ fees, as well as injunctive relief. Roger Cleveland has been an employee of Callaway since 1996 and has been designing golf clubs for Callaway for over 17 years.

Historically, the claims, proceedings and investigations brought against the Company, individually, and in the aggregate, have not had a material adverse effect upon the consolidated results of operations, cash flows, or financial position of the Company. The Company believes that it has valid legal defenses to the matters currently pending against the Company, including the Cleveland Golf litigation noted above. These matters, including the matter specifically described above, are inherently unpredictable and the resolutions of these matters are subject to many uncertainties and the outcomes are not predictable with assurance. Consequently, management is unable to estimate the ultimate aggregate amount of monetary loss, amounts covered by insurance, or the financial impact that will result from such matters. Management believes that the final resolution of the current matters pending against the Company, individually and in the aggregate, will not have a material adverse effect upon the Company’s consolidated financial position. The Company’s results of operations or cash flows, however, could be materially affected in any particular period by the unfavorable resolution of one or more of these contingencies.

Unconditional Purchase Obligations

During the normal course of its business, the Company enters into agreements to purchase goods and services, including purchase commitments for production materials, endorsement agreements with professional golfers and other endorsers, employment and consulting agreements, and intellectual property licensing agreements pursuant to which the Company is required to pay royalty fees. It is not possible to determine the amounts the Company will ultimately be required to pay under these agreements as they are subject to many variables including performance-based bonuses, reductions in payment obligations if designated minimum performance criteria are not achieved, and severance arrangements. As of September 30, 2013, the Company has entered into many of these contractual agreements with terms ranging from one to five years. The minimum obligation that the Company is required to pay under these agreements is $60,566,000 over the next five years. In addition, the Company also enters into unconditional purchase obligations with various vendors and suppliers of goods and services in the normal course of operations through purchase orders or other documentation or that are undocumented except for an invoice. Such unconditional purchase obligations are generally outstanding for periods less than a year and are settled by cash payments upon delivery of goods and services and are not reflected in this total.

Future purchase commitments as of September 30, 2013, are as follows (in thousands):

Remainder of 2013	$43,781
2014	13,298
2015	2,327
2016	839
2017	321
	$60,566

Other Contingent Contractual Obligations

During its normal course of business, the Company has made certain indemnities, commitments and guarantees under which it may be required to make payments in relation to certain transactions. These include (i) intellectual property indemnities to the Company’s customers and licensees in connection with the use, sale and/or license of Company product or trademarks, (ii) indemnities to various lessors in connection with facility leases for certain claims arising from such facilities or leases, (iii) indemnities to vendors and service providers pertaining to the goods and services provided to the Company or based on the negligence or willful misconduct of the Company, and (iv) indemnities involving the accuracy of representations and warranties in certain contracts. In addition, the Company has consulting agreements that provide for payment of nominal fees upon the issuance of patents and/or the commercialization of research results. The Company has also issued guarantees in the form of a standby letter of credit as security for contingent liabilities under certain workers' compensation insurance policies.

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The duration of these indemnities, commitments and guarantees varies, and in certain cases, may be indefinite. The majority of these indemnities, commitments and guarantees do not provide for any limitation on the maximum amount of future payments the Company could be obligated to make. Historically, costs incurred to settle claims related to indemnities have not been material to the Company's financial position, results of operations or cash flows. In addition, the Company believes the likelihood is remote that material payments under the commitments and guarantees described above will have a material effect on the Company's financial condition. The fair value of indemnities, commitments and guarantees that the Company issued during the nine months ended September 30, 2013 was not material to the Company's financial position, results of operations or cash flows.

Employment Contracts

In addition, the Company has made contractual commitments to each of its officers and certain other employees providing for severance payments, including salary continuation, upon the termination of employment by the Company for convenience or by the officer for substantial cause. In addition, in order to assure that the officers would continue to provide independent leadership consistent with the Company's best interest, the contracts also generally provide for certain protections in the event of an actual or threatened change in control of the Company. These protections include the payment of certain severance benefits, such as salary continuation, upon the termination of employment following a change in control.

Note 14. Share-Based Employee Compensation

As of September 30, 2013, the Company had two shareholder approved stock plans under which shares were available for equity-based awards: the Callaway Golf Company Amended and Restated 2004 Incentive Plan and the 2013 Non-Employee Directors Stock Incentive Director Plan. From time to time, the Company grants stock options, restricted stock units, phantom stock units, stock appreciation rights and other awards under these plans.

The table below summarizes the amounts recognized in the financial statements for the three and nine months ended September 30, 2013 and 2012 for share-based compensation, including expense for stock options, restricted stock units, phantom stock units and cash settled stock appreciation rights (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2013	2012	2013	2012
Cost of sales	$84	$28	$229	$175
Operating expenses	1,804	1,182	4,028	4,911
Total cost of share-based compensation included in income, before income tax	$1,888	$1,210	$4,257	$5,086

Stock Options

During the nine months ended September 30, 2013 the Company granted 1,843,000 shares underlying stock options at a weighted average grant-date fair value of $2.47 per share based on the Black Scholes option-pricing model. There were no stock options granted during the third quarter of 2013. Total compensation expense recognized for stock options during the three and nine months ended September 30, 2013 was $486,000 and $1,333,000, respectively. During the nine months ended September 30, 2012, the number of shares underlying stock options granted was nominal and no stock options were granted during the third quarter of 2012. Total compensation expense recognized for stock options during the three and nine months ended September 30, 2012 was $253,000 and $1,310,000, respectively.

The Company records compensation expense for employee stock options based on the estimated fair value of the options on the date of grant using the Black-Scholes option-pricing model.

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The table below summarizes the weighted average Black-Scholes fair value assumptions used in the valuation of stock options granted during the nine months ended September 30, 2013 and 2012.

	Nine Months Ended September 30,			
	2013		2012	
Dividend yield	0.6	%	1.2	%
Expected volatility	48.8	%	50.6	%
Risk free interest rate	0.7	%	0.8	%
Expected life	4.3 years		4.9 years	

Restricted Stock Units
The Company granted 441,000 shares underlying restricted stock units during the nine months ended September 30, 2013 at a weighted average grant-date fair value of $6.55 per share. There were no restricted stock units granted during the third quarter of 2013. Total compensation expense recognized for restricted stock units during the three and nine months ended September 30, 2013 was $436,000 and $1,258,000, respectively.
During the three and nine months ended September 30, 2012 the Company granted 10,000 and 393,000 shares underlying restricted stock units, respectively, at a weighted average grant-date fair value of $5.75 and $6.36 per share, respectively. Total compensation expense recognized for restricted stock units during the three and nine months ended September 30, 2012 was $332,000 and $1,172,000, respectively.
At September 30, 2013, the Company had $3,901,000 of total unrecognized compensation expense related to non-vested restricted stock units under the Company’s share-based payment plans. The amount of unrecognized compensation expense noted above does not necessarily represent the amount that will ultimately be realized by the Company in its consolidated condensed statement of operations due to the application of forfeiture rates.
Phantom Stock Units
Phantom stock units (“PSUs”) are a form of share-based award that are indexed to the Company’s stock and are settled in cash. Because PSUs are settled in cash, compensation expense recognized over the vesting period will vary based on changes in fair value. Fair value is remeasured at the end of each interim reporting period based on the closing price of the Company’s stock. PSUs generally cliff vest at the end of a three year period.
During the nine months ended September 30, 2012, the Company granted 401,000 shares of PSUs, respectively, with a grant-date fair value of $6.37 per share. The Company did not grant PSUs in the first nine months of 2013. Compensation expense recognized during the three and nine months ended September 30, 2013 was $430,000 and $947,000, respectively, and $361,000 and $1,355,000 during the three and nine months ended September 30, 2012. Accrued compensation expense for PSUs for the three months ended September 30, 2013 was $2,247,000, of which $1,198,000 and $1,049,000 was recorded in accrued employee compensation and benefits and long-term incentive compensation and other, respectively, in the accompanying consolidated condensed balance sheets. At December 31, 2012, the Company accrued $1,324,000 in long-term incentive compensation and other in the accompanying consolidated condensed balance sheet. There was no accrual in accrued employee compensation and benefits at December 31, 2012.
Stock Appreciation RightsThe Company records compensation expense for cash settled stock appreciation rights (“SARs”) based on the estimated fair value on the date of grant using the Black Scholes option-pricing model. SARs are subsequently remeasured at each interim reporting period based on a revised Black Scholes value until they are exercised. SARs vest over a three year period. During the nine months ended September 30, 2012, the Company granted 3,377,000 SARs at a weighted average grant-date fair value of $2.07 per share based on the Black Scholes option-pricing model. The Company did not grant SARs during the third quarter of 2013 and 2012, or during the nine months ended September 30, 2013. The Company recognized compensation expense of $536,000 and $719,000 during the three and nine months ended September 30, 2013, respectively, and $264,000 and $1,250,000 during the

three and nine months ended September 30, 2012, respectively. At September 30, 2013, the Company accrued compensation expense of $3,252,000, of which $2,705,000 and $547,000 was included in accrued employee compensation and benefits and long-term incentive compensation and other, respectively, in the accompanying consolidated condensed balance sheet. At December 31, 2012, the Company accrued compensation expense of $2,607,000, of which $1,819,000 and $788,000 was included in accrued employee compensation and benefits and long-term incentive compensation and other, respectively, in the accompanying consolidated condensed balance sheet.

Note 15. Fair Value of Financial Instruments

Certain of the Company's financial assets and liabilities are measured at fair value on a recurring and nonrecurring basis. Fair value is defined as the price that would be received to sell an asset or the price paid to transfer a liability (the exit price) in the principal and most advantageous market for the asset or liability in an orderly transaction between market participants. Assets and liabilities carried at fair value are classified using the following three-tier hierarchy:

Level 1: Quoted market prices in active markets for identical assets or liabilities;

Level 2: Quoted prices for similar instruments in active markets; quoted prices for identical or similar instruments in markets that are not active; and model-derived valuations in which significant inputs and significant value drivers are observable in active markets; and

Level 3: Fair value measurements derived from valuation techniques in which one or more significant inputs or significant value drivers are unobservable.

The following table summarizes the valuation of the Company's foreign currency exchange contracts (see Note 16) that are measured at fair value on a recurring basis by the above pricing levels at September 30, 2013 (in thousands):

	Fair Value	Level 1	Level 2	Level 3
Foreign currency derivative instruments—asset position	$536	$—	$536	$—
Foreign currency derivative instruments—liability position	(3,286)	—	(3,286)	—
	$(2,750)	$—	$(2,750)	$—

The fair value of the Company's foreign currency exchange contracts is based on observable inputs that are corroborated by market data. Foreign currency derivatives on the balance sheet are recorded at fair value with changes in fair value recorded in the statements of operations.

Disclosures about the Fair Value of Financial Instruments

The carrying values of cash and cash equivalents, trade accounts receivable and trade accounts payable and accrued expenses at September 30, 2013 and December 31, 2012 are reasonable estimates of fair value due to the short-term nature of these balances. The table below illustrates information about fair value relating to the Company's financial assets and liabilities that are recognized on the accompanying consolidated condensed balance sheets as of September 30, 2013 and December 31, 2012, as well as the fair value of contingent contracts that represent financial instruments (in thousands).

	September 30, 2013		December 31, 2012	
	Carrying Value	Fair Value	Carrying Value	Fair Value
Convertible notes(1)	$107,656	$126,000	$107,133	$118,406
Standby letters of credit(2)	$1,278	$1,278	$3,265	$3,265

(1) The carrying value of the convertible notes at September 30, 2013 and December 31, 2012, is net of the unamortized discount of $4,844,000 and $5,367,000, respectively (see Note 3). The fair value of the convertible notes was determined based on secondary quoted market prices, and as such is classified as Level 2 in the fair value hierarchy.

(2) Amounts outstanding under standby letters of credit represent the Company's contingent obligation to perform in accordance with the underlying contracts to which they pertain. The fair value of standby letters is classified as Level 1 as it approximates the carrying value due to the short term nature of these obligations.Nonrecurring Fair Value Measurements The Company measures certain assets at fair value on a nonrecurring basis at least annually or when certain indicators are present. These assets include property, plant and equipment, goodwill and

non-amortizing intangible assets that are written down to fair value when they are held for sale or determined to be impaired. During the three and nine months ended September 30, 2012, in connection with the Cost Reduction Initiatives (Note 2), the Company committed to a plan to sell its golf ball manufacturing facility in Chicopee, Massachusetts and lease back a reduced portion of the square footage to accommodate lower ball inventory volumes manufactured at that location. In connection with designating this building as available for sale, the Company recorded a charge of $7,939,000 to write the building down to its estimated selling price, net of estimated commissions and fees. This implied fair market value was based on significant unobservable inputs, and as a result, the fair value measurement was classified as Level 3. There were no nonrecurring fair value measurements during the three and nine months ended September 30, 2013

Note 16. Derivatives and Hedging

Foreign Currency Exchange Contracts

The Company accounts for its foreign currency exchange contracts in accordance with ASC Topic 815, "Derivatives and Hedging" ("ASC 815"). ASC 815 requires the recognition of all derivatives as either assets or liabilities on the balance sheet, the measurement of those instruments at fair value and the recognition of changes in the fair value of derivatives in earnings in the period of change, unless the derivative qualifies as an effective hedge that offsets certain exposures.

In the normal course of business, the Company is exposed to gains and losses resulting from fluctuations in foreign currency exchange rates relating to transactions of its international subsidiaries, including certain balance sheet exposures (payables and receivables denominated in foreign currencies). In addition, the Company is exposed to gains and losses resulting from the translation of the operating results of the Company's international subsidiaries into U.S. dollars for financial reporting purposes. As part of its strategy to manage the level of exposure to the risk of fluctuations in foreign currency exchange rates, the Company uses derivative financial instruments in the form of foreign currency forward contracts and put and call option contracts ("foreign currency exchange contracts") to hedge transactions that are denominated primarily in Japanese Yen, British Pounds, Euros, Canadian Dollars, Australian Dollars and Korean Won. Foreign currency exchange contracts are used only to meet the Company's objectives of minimizing variability in the Company's operating results arising from foreign exchange rate movements. The Company does not enter into foreign currency exchange contracts for speculative purposes. Foreign currency exchange contracts usually mature within twelve months from their inception.

The Company did not designate any foreign currency exchange contracts as derivatives that qualify for hedge accounting under ASC 815. At September 30, 2013 and December 31, 2012, the notional amounts of the Company's foreign currency exchange contracts used to hedge the exposures discussed above were approximately $102,369,000 and $137,125,000, respectively. The Company estimates the fair values of foreign currency exchange contracts based on pricing models using current market rates, and records all derivatives on the balance sheet at fair value with changes in fair value recorded in the statements of operations.

The following table summarizes the fair value of derivative instruments by contract type as well as the location of the asset and/or liability on the consolidated condensed balance sheets at September 30, 2013 and December 31, 2012 (in thousands):

Derivatives not designated as hedging instruments	Asset Derivatives			
	September 30, 2013		December 31, 2012	
	Balance Sheet Location	Fair Value	Balance Sheet Location	Fair Value
Foreign currency exchange contracts	Other current assets	$536	Other current assets	$5,011

Derivatives not designated as hedging instruments	Liability Derivatives			
	September 30, 2013		December 31, 2012	
	Balance Sheet Location	Fair Value	Balance Sheet Location	Fair Value
Foreign currency exchange contracts	Accounts payable and accrued expenses	$3,286	Accounts payable and accrued expenses	$1,046

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The following table summarizes the location of net gains and losses in the consolidated condensed statements of operations that were recognized during the three and nine months ended September 30, 2013 and 2012, respectively, in addition to the derivative contract type (in thousands):

Derivatives not designated as hedging instruments	Location of net gain (loss) recognized in income on derivative instruments	Amount of Net Gain (Loss) Recognized in Income on Derivative Instruments			
		Three Months Ended September 30,		Nine Months Ended September 30,	
		2013	2012	2013	2012
Foreign currency exchange contracts	Other income (expense), net	$(5,565)	$(4,884)	$7,238	$(1,399)

The realized and unrealized net gains and losses noted in the table above for the three and nine months ended September 30, 2013 and 2012 were used by the Company to offset actual foreign currency transactional net gains and losses associated with the translation of foreign currencies in operating results.

Note 17. Segment Information

The Company has two operating segments that are organized on the basis of products and include golf clubs and golf balls. The golf clubs segment consists primarily of Callaway Golf woods, hybrids, irons and wedges, Odyssey putters, pre-owned clubs, rangefinders, and other golf-related accessories and royalties from licensing of the Company's trademarks and service marks. The golf balls segment consists primarily of Callaway Golf balls that are designed, manufactured and sold by the Company. During the first quarter of 2012, the Company completed the sale of certain assets related to the Top-Flite and Ben Hogan brands. In addition, during the third quarter of 2012, the Company announced the transition of its North American golf apparel and footwear and global GPS device businesses to a third party based model. As such, the net sales and income before income taxes for the three and nine months ended September 30, 2013 include minimal sales of Top-Flite and Ben Hogan golf products as well as sales of golf apparel, footwear and uPro GPS on-course measurement devices. There are no significant intersegment transactions.

The table below contains information utilized by management to evaluate its operating segments for the interim periods presented (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2013	2012	2013	2012
Net sales:				
Golf Clubs	$152,610	$121,286	$603,599	$595,123
Golf Balls	25,619	26,620	112,032	119,004
	$178,229	$147,906	$715,631	$714,127
Income (loss) before income taxes:				
Golf Clubs(1)	$(4,410)	$(57,840)	$60,410	$(7,247)
Golf Balls(1)	(3,420)	(13,789)	3,474	(8,047)
Reconciling items(2)	(12,286)	(14,419)	(28,365)	(34,249)
	$(20,116)	$(86,048)	$35,519	$(49,543)
Additions to long-lived assets:				
Golf Clubs	$4,236	$2,242	$10,669	$14,956
Golf Balls	66	83	95	323
	$4,302	$2,325	$10,764	$15,279

(1) In connection with the Cost Reduction Initiatives (see Note 2), the Company’s golf clubs and golf balls segments recognized pre-tax charges of $990,000 and $454,000, respectively, during the three months ended September 30, 2013, and $23,603,000 and $9,317,000, respectively, during the three months ended September 30, 2012. The Company's golf clubs and golf balls segments recognized pre-tax charges of $4,261,000 and $4,682,000, respectively, during the nine months

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ended September 30, 2013, in connection with these initiatives, and $25,290,000 and $9,650,000, respectively, during the nine months ended September 30, 2012.

(2) Reconciling items represent corporate general and administrative expenses and other income (expense) not included by management in determining segment profitability. During the three and nine months ended September 30, 2013, the reconciling items include pre-tax charges of $414,000 and $1,423,000, respectively, related to the Cost Reduction Initiatives. During the three and nine months ended September 30, 2012, the reconciling items include pre-tax charges of $2,164,000 and $4,815,000, respectively, in connection with these initiatives. In addition, reconciling items for the nine months ended September 30, 2012, include a pre-tax gain of $6,602,000 in connection with the sale of Top-Flite and Ben Hogan brands.

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

The following discussion should be read in conjunction with the Consolidated Condensed Financial Statements and the related notes that appear elsewhere in this report. See also "Important Notice to Investors Regarding Forward-Looking Statements" on page 2 of this report.

Results of Operations

Overview of Business and Seasonality

The Company designs, manufactures and sells high quality golf clubs and golf balls and also sells golf apparel, golf footwear, golf bags, gloves, eyewear and other golf-related accessories. The Company designs its products to be technologically advanced and in this regard invests a considerable amount in research and development each year. The Company's golf products are designed for golfers of all skill levels, both amateur and professional.

The Company has two operating segments that are organized on the basis of products, namely the golf clubs segment and golf balls segment. The golf clubs segment consists primarily of Callaway woods, hybrids, irons, wedges and Odyssey putters. This segment also includes other golf-related accessories described above and royalties from licensing of the Company's trademarks and service marks as well as sales of pre-owned golf clubs. The golf balls segment consists primarily of Callaway golf balls as a result of the sale of the Top-Flite brand during the first quarter of 2012. As discussed in Note 17 "Segment Information" to the Notes to Consolidated Condensed Financial Statements, the Company's operating segments exclude a significant amount of corporate general administrative expenses and other income (expense) not utilized by management in determining segment profitability.

In most of the regions where the Company does business, the game of golf is played primarily on a seasonal basis. Weather conditions generally restrict golf from being played year-round, except in a few markets, with many of the Company's on-course customers closing for the cold weather months. The Company's business is therefore subject to seasonal fluctuations. In general, during the first quarter, the Company begins selling its products into the golf retail channel for the new golf season. This initial sell-in generally continues into the second quarter. The Company's second quarter sales are significantly affected by the amount of reorder business of the products sold during the first quarter. The Company's third quarter sales are generally dependent on reorder business but are generally less than the second quarter as many retailers begin decreasing their inventory levels in anticipation of the end of the golf season. The Company's fourth quarter sales are generally less than the other quarters due to the end of the golf season in many of the Company's key markets. However, fourth quarter sales can be affected from time to time by the early launch of product introductions related to the new golf season of the subsequent year. This seasonality, and therefore quarter to quarter fluctuations, can be affected by many factors, including the timing of new product introductions as well as weather conditions. In general, however, because of this seasonality, a majority of the Company's sales and most, if not all, of its profitability generally occurs during the first half of the year.

More than half of the Company's business is conducted outside of the United States and is conducted in currencies other than the U.S. dollar. As a result, changes in foreign currency rates can have a significant effect on the Company's financial results. The Company enters into foreign currency exchange contracts to mitigate the effects of changes in foreign currency rates. While these foreign currency exchange contracts can mitigate the effects of changes in foreign currency rates, they do not eliminate those effects, which can be significant. These effects include (i) the translation of results denominated in foreign currency into U.S. dollars for reporting purposes, (ii) the mark-to-market adjustments of certain intercompany balance sheet accounts denominated in foreign currencies, and (iii) the mark-to-market adjustments on the Company's foreign currency exchange contracts. In general, the Company's overall financial results are affected positively by a weaker U.S. dollar and are affected negatively by a stronger U.S. dollar as compared to the foreign currencies in which the Company conducts its business. The Company's reported net sales in regions outside the U.S. in 2013 were negatively affected by the translation of foreign currency sales into U.S. dollars based on 2013 exchange rates. If 2012 exchange rates were applied to 2013 reported sales in regions outside the U.S. and all other factors were held constant, net sales in such regions would have been $31.5 million higher than the net sales reported in the first nine months of 2013.

Executive Summary

The Company’s results for the three and nine months ended September 30, 2013 include sales growth as well as significant improvements in gross margins, operating expenses, and operating income compared to the same periods in the prior year. These financial results reflect the continued success of the Company’s turnaround plan, including continued improvement in the development of more performance-oriented products, brand momentum, operating efficiencies, and cost management.

The Company’s net sales increased approximately 21% for the third quarter of 2013 and less than 1% for the first nine months of 2013 compared to the same periods in the prior year. The Company achieved these results despite adverse changes in foreign currency rates, the sale in 2012 of the Top-Flite and Ben Hogan Brands, and the transition to a licensing arrangement for apparel and footwear in North America. The sale of these brands and licensing arrangements negatively impacted sales by $53.4 million for the first nine months in 2013 and by $8.7 million for the third quarter of 2013 compared to the same periods in 2012. In addition, changes in foreign currency rates negatively affected net sales by $31.5 million for the first nine months of 2013, and by $13.7 million for the third quarter of 2013, as compared to the same periods in 2012. On a constant currency basis, the Company’s current business, which excludes the sold or transitioned brands and businesses, achieved 13% sales growth for the first nine months of 2013, and 38% sales growth for the third quarter of 2013, compared to the same periods in 2012.

In addition to improved sales, the Company's gross margin and operating expenses improved and the charges related to the Cost Reduction Initiatives were significantly less during 2013 compared to 2012. Gross margin increased by 650 basis points to 39.9% during the first nine months of 2013 compared to 33.4% during the same period in 2012. This improvement was primarily driven by (i) a $20.9 million decline in charges associated with the Company’s 2012 Cost Reduction Initiatives, (ii) increased sales of higher margin woods products in 2013, primarily due to the current year success of the X Hot line of woods and mid-year product launches, and (iii) less promotional activity by the Company in the current year. Gross margin was also favorably affected by improved manufacturing efficiencies and a lower cost structure resulting from the Company's Cost Reduction Initiatives. Additionally, as a result of these initiatives, as well as a continued focus on cost management, the Company's operating expenses improved by $33.2 million or 12% during the first nine months of 2013 compared to the same period in 2012. In total, the Company incurred charges of $10.4 million in connection with the Cost Reduction Initiatives during the first nine months of 2013 compared to $39.8 million during the same period in 2012.

These improvements, along with the Company’s improved brand momentum resulting from the success of the Company’s 2013 product line, enabled the Company to overcome the adverse effects of changes in foreign currency rates, and the impact of the sold or transitioned businesses. The Company also has been able to grow its hard goods market share and manage inventory levels both internally and at retail despite challenges this year due to adverse weather conditions and higher than normal competitor promotional activity at retail in both North America and Europe. As a result, the Company's income from operations and diluted earnings per share increased to $34.6 million and $0.36, respectively, for the first nine months of 2013 compared to a loss from operations of $45.3 million and diluted loss per share of $0.91 for the same period in 2012.

Three-Month Periods Ended September 30, 2013 and 2012

Net sales for the third quarter of 2013 increased $30.3 million to $178.2 million compared to $147.9 million in the third quarter of 2012. This increase was primarily due to the strong performance of the current year X Hot family of products combined with the current quarter launch of the FT Optiforce drivers and Mack Daddy 2 wedges with no comparable product launch in the third quarter of the prior year. This increase was offset by the sale of the Top-Flite and Ben Hogan brands in 2012 combined with a decline in sales of the Company’s accessories and other products due to the transition of the Company’s apparel and footwear sales in the U.S. to a licensing arrangement during the second half of 2012. Combined, the sale/transition of these businesses negatively affected sales by approximately $8.7 million in the third quarter of 2013 compared to 2012. Additionally, the Company’s net sales for the third quarter of 2013 were negatively impacted by $13.7 million resulting from unfavorable fluctuations in foreign currency rates.

The Company’s net sales by operating segment are presented below (dollars in millions):

	Three Months Ended September 30,		Growth/(Decline)	
	2013	2012	Dollars	Percent
Net sales:				
Golf clubs	$152.6	$121.3	$31.3	26 %
Golf balls	25.6	26.6	(1.0)	(4)%
	$178.2	$147.9	$30.3	20 %

For further discussion of each operating segment’s results, see “Golf Clubs and Golf Balls Segments Results” below.
Net sales information by region is summarized as follows (dollars in millions):

	Three Months Ended September 30,		Growth/(Decline)	
	2013	2012	Dollars	Percent
Net sales:				
United States	$67.0	$57.1	$9.9	17 %
Europe	26.5	19.2	7.3	38 %
Japan	48.6	41.6	7.0	17 %
Rest of Asia	23.7	16.1	7.6	47 %
Other countries	12.4	13.9	(1.5)	(11)%
	$178.2	$147.9	$30.3	20 %

Net sales in the United States increased $9.9 million (17%) to $67.0 million during the third quarter of 2013 compared to the same period in the prior year. Despite the unfavorable impact of fluctuations in foreign currency rates, the Company’s sales in regions outside of the United States increased $20.4 million to $111.2 million for the third quarter of 2013 compared to $90.8 million in the same quarter of 2012. As mentioned above, the increase in net sales in all regions resulted from the favorable consumer acceptance of the Company's current year products combined with the timing of current quarter product launches. This increase was partially offset by the unfavorable impact of the translation of foreign currency sales into U.S. Dollars based upon 2013 exchange rates. If 2012 exchange rates were applied to 2013 reported sales in regions outside the U.S. and all other factors were held constant, net sales in such regions would have been $13.7 million higher than reported in the third quarter of 2013.

The Company’s cost of sales is comprised primarily of material and component costs, distribution and warehousing costs, and overhead. In general, on a consolidated basis, approximately 80% - 85% of total cost of sales is variable in nature and will fluctuate with sales volumes. Of this amount, approximately 80% - 85% is comprised of material and component costs. Generally, the relative significance of the components of costs of sales does not vary materially from period to period. See “Segment Profitability” below for further discussion of gross margins.

Gross profit increased $55.6 million to $59.4 million for the third quarter of 2013 compared to $3.8 million in the third quarter of 2012. Gross profit as a percentage of net sales (“gross margin”) increased to 33.3% in the third quarter of 2013 compared to 2.6% in the third quarter of 2012. This improvement was primarily due to a $26.3 million decline in charges associated with the Company's Cost Reduction Initiatives. Gross margin in the third quarter of 2013 was also favorably impacted by increased sales of higher margin woods products in 2013, primarily due to the current year success of the X Hot line of woods, combined with less promotional activity and more full priced sales resulting from the current quarter launch of the premium FT Optiforce woods products and Mack Daddy 2 wedges. The Company also realized improved manufacturing efficiencies in 2013 as a result of its Cost Reduction Initiatives. These increases were partially offset by the unfavorable impact of changes in foreign currency rates.

Selling expenses decreased by $10.4 million to $49.9 million (28.0% of net sales) in the third quarter of 2013 compared to $60.3 million (40.8% of net sales) in the comparable period of 2012. This decrease was primarily due to a $6.1 million decline in employee costs, travel and entertainment, and expenses in connection with the Company's transition of its apparel and footwear businesses to a licensing model as a result of the Company's Cost Reduction Initiatives. In addition, marketing expenses decreased by $2.6 million.

General and administrative expenses increased by $0.7 million to $18.9 million (10.6% of net sales) in the third quarter of 2013 compared to $18.2 million (12.3% of net sales) in the comparable period of 2012. This increase was primarily due to a $2.8 million increase in bad debt expense, partially offset by a $1.7 million decrease in costs associated with the Company's Cost Reduction Initiatives, mostly related to employee costs and expenses in connection with the Company's wind-down of its GPS device business.

Research and development expenses decreased by $0.3 million to $7.7 million (4.3% of net sales) in the third quarter of 2013 compared to $8.0 million (5.4% of net sales) in the comparable period of 2012. This decrease was primarily due to a decline in costs associated with the Company's Cost Reduction Initiatives, mostly related to the Company's wind-down of its GPS device business.

Other income (expense), net decreased in the third quarter of 2013 to other expense of $3.1 million compared to other expense of $3.4 million in the comparable period of 2012. This improvement was primarily due to an increase in net foreign currency gains in the third quarter of 2013 compared to the same period in 2012, partially offset by an increase in interest expense.

The Company’s provision for income taxes was $1.0 million for the third quarter of 2013, compared to $0.8 million for the third quarter of 2012. The $0.2 million increase resulted primarily from the release of certain unrecognized tax liabilities during the third quarter of 2012 resulting from the lapse of certain statutes of limitation. Due to the effects of the Company’s valuation allowance against its U.S. deferred tax assets, the Company’s effective tax rate for the third quarter of 2013 is not comparable to the effective tax rate for the third quarter of 2012 as the Company’s income tax amount is not directly correlated to the amount of its pretax income.

Net loss for the third quarter of 2013 decreased to $21.2 million compared to $86.8 million in the comparable quarter of 2012. Diluted losses per share improved to $0.32 in the third quarter of 2013 compared to $1.33 in the comparable period of 2012. The Company’s net loss for the third quarter of 2013 and 2012 includes the following charges and gains (in millions):

	Three Months Ended September 30, 2013	Three Months Ended September 30, 2012
Pre-tax charges related to the Cost Reduction Initiatives	$(1.9)	$(35.1)
Income tax provision(1)	(1.0)	(0.8)
Total charges	$(2.9)	$(35.9)

(1) The Company’s income tax provision for 2013 and 2012 is affected by the establishment of a valuation allowance against the Company’s U.S. deferred tax assets and is therefore not directly correlated to the amount of its pretax income. See Note 12 “Income Taxes” to the Notes to Consolidated Condensed Financial Statements included in this Form 10-Q.

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Golf Clubs and Golf Balls Segments Results for the Three Months Ended September 30, 2013 and 2012

Golf Clubs Segment

Net sales information by product category is summarized as follows (dollars in millions):

	Three Months Ended September 30,		Growth/(Decline)	
	2013	2012	Dollars	Percent
Net sales:				
Woods	$56.5	$31.2	$25.3	81 %
Irons	39.5	31.0	8.5	27 %
Putters	20.4	15.7	4.7	30 %
Accessories and other	36.2	43.4	(7.2)	(16)%
	$152.6	$121.3	$31.3	26 %

The $25.3 million (81%) increase in net sales of woods to $56.5 million for the quarter ended September 30, 2013 resulted from an increase in both sales volume and average selling prices. The increase in sales volume was primarily due to the strong performance of the X Hot woods, which performed better at retail than the prior year Razr X woods, in addition to the midyear launch of FT Optiforce woods. The increase in average selling prices was due to the introduction of the X Hot and Razr Fit Xtreme woods at higher average selling prices than their predecessors, the Razr X and Razr Fit woods sold during the same period in the prior year, as well as the midyear launch of FT Optiforce woods. In addition, there was less promotional activity during the third quarter of 2013 compared to the third quarter in 2012.

The $8.5 million (27%) increase in net sales of irons to $39.5 million for the quarter ended September 30, 2013 was primarily attributable to an increase in average selling prices as well as sales volumes. The increase in average selling prices was due to the introduction of the Mack Daddy 2 wedges and X Hot irons at higher average selling prices than many of the iron and wedge models launched in the prior year. The increase in sales volumes was primarily due to the current quarter launch of the Company's Mack Daddy 2 wedges with no comparable wedge launch in the third quarter of the prior year.

The $4.7 million (30%) increase in net sales of putters to $20.4 million for the quarter ended September 30, 2013 was primarily attributable to an increase in both sales volume and average selling prices. The increase in sales volumes was due to an increase in sales of the Company’s current year Versa, White Hot Pro and Tank putter models compared to the Metal X and White Ice putters in the prior year. The increase in average selling prices was due to a decline in promotional activity in the third quarter of 2013 compared to the prior year.

The $7.2 million (16%) decrease in net sales of accessories and other products to $36.2 million for the quarter ended September 30, 2013 was primarily due to the transition of the Company’s apparel and footwear sales in the U.S. to a licensing arrangement during the second half of 2012 combined with a decline in sales of GPS devices.

Golf Balls Segment

Net sales information for the golf balls segment is summarized as follows (dollars in millions):

	Three Months Ended September 30,		Decline	
	2013	2012	Dollars	Percent
Net sales:				
Golf balls	$25.6	$26.6	$(1.0)	(4)%

The $1.0 million (4%) decrease in net sales of golf balls to $25.6 million for the quarter ended September 30, 2013 was primarily due to a decline in sales volume slightly offset by an increase in average selling prices. The decrease in sales volume was primarily due to an $2.9 million decline in sales of Top-Flite golf balls due to the sale of the Top-Flite brand during the first quarter of 2012 partially offset by an 8% increase in sales of Callaway golf balls during the third quarter of 2013 compared to the same period in the prior year. The increase in average selling prices resulted from a shift in product mix from sales of lower priced Top-Flite balls in 2012 to increased sales of higher priced Callaway branded golf balls in 2013.

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Cost of Sales and Segment Profitability

The Company's cost of sales is comprised primarily of material and component costs, distribution and warehousing costs, and overhead. In general, approximately 65% - 70% and 85% - 90% of the Company's golf ball and golf club cost of sales, respectively, is variable in nature. Of these amounts, approximately 75% - 80% and 80% - 85%, respectively, is comprised of material and component costs. Generally, the relative significance of the components of costs of sales does not vary materially from period to period.

Profitability by operating segment is summarized as follows (dollars in millions):

	Three Months Ended September 30,		Growth	
	2013	2012	Dollars	Percent
Loss before income taxes:				
Golf clubs[1]	$(4.4)	$(57.8)	$53.4	92%
Golf balls[1]	(3.4)	(13.8)	10.4	75%
Reconciling items[2]	(12.3)	(14.4)	2.1	15%
	$(20.1)	$(86.0)	$65.9	77%

(1) In connection with the Cost Reduction Initiatives (see Note 2 "Cost Reduction Initiatives" to the Notes to Consolidated Condensed Financial Statements), during the three months ended September 30, 2013 and 2012, the Company's golf clubs segment recognized pre-tax charges of $1.0 million and $23.6 million, respectively, and the golf balls segment recognized pre-tax charges of $0.5 million and $9.3 million, respectively, related to these initiatives.

(2) Reconciling items represent corporate general and administrative expenses and other income (expense) not included by management in determining segment profitability. For the third quarter of 2013 and 2012, the reconciling items include pre-tax charges of $0.4 million and $2.2 million, respectively, related to the Cost Reduction Initiatives.

Pre-tax loss in the Company's golf clubs operating segment decreased to $4.4 million for the third quarter of 2013 from $57.8 million for the comparable period in the prior year. This decrease was primarily driven by an increase in gross margin from 4.8% for the third quarter of 2012 to 34.7% in the third quarter of 2013, combined with an increase in net sales as discussed above and a decrease in operating expenses as a result of net savings realized from the Cost Reduction Initiatives. The improvement in gross margin was primarily driven by charges recognized during the third quarter of 2012 in connection with the Company's Cost Reduction Initiatives, which negatively affected prior year gross margin by 19.5% within the golf clubs operating segment. In addition, gross margin was favorably impacted in 2013 by (i) a favorable shift in product mix to increased sales of woods products, primarily sales of the X Hot family of woods, which were introduced at a higher average selling price than the Razr X family of woods in 2012 as well as increased sales of the X Hot family of irons and Mack Daddy 2 wedges, both of which have higher margins relative to the value priced irons sold during the third quarter of 2012; (ii) an overall decrease in promotional activity combined with more full priced sales resulting from the current quarter launch of the premium FT Optiforce woods products and Mack Daddy 2 wedges; and (iii) improved manufacturing efficiencies and improvements to the Company's cost structure resulting from the Cost Reduction Initiatives. These increases were partially offset by an increase in club component costs due to more expensive materials and technology incorporated into the X Hot family of woods and White Hot Pro putters, as well as the impact of unfavorable foreign currency rates.

Pre-tax loss in the Company’s golf balls operating segment decreased to $3.4 million for the third quarter of 2013 from $13.8 million for the comparable period in the prior year. This decrease was primarily attributable to a significant improvement in gross margin combined with a decrease in operating expenses as a result of net savings realized from the Cost Reduction Initiatives, partially offset by a decrease in net sales as discussed above. The increase in gross margin was primarily driven by charges recognized during the third quarter of 2012 in connection with the Company's Cost Reduction Initiatives, which negatively affected prior year gross margin by 35.0% within the golf balls operating segment. In addition, gross margin was positively impacted by improved manufacturing efficiencies and improvements to the Company's cost structure resulting from the Cost Reduction Initiatives. Gross margin was negatively impacted by a shift in sales in the third quarter of 2013 to more moderately priced and value priced golf balls compared to higher sales of premium golf balls in the comparable quarter of 2012, as well as the impact of unfavorable foreign currency rates.

Nine-Month Periods Ended September 30, 2013 and 2012

Net sales for the nine months ended September 30, 2013 increased $1.5 million to $715.6 million compared to $714.1 million for the same period in 2012. This increase was primarily due to an increase in sales of woods resulting from the successful performance of the Company’s X Hot woods which were introduced during the current year. This increase was offset by the sale of the Top-Flite and Ben Hogan brands in 2012 combined with a decline in sales of the Company’s accessories and other products due to the transition of the Company’s apparel and footwear sales in the U.S. to a licensing arrangement during the second half of 2012. Combined, the sale/transition of these businesses negatively affected sales by approximately $53.4 million for the first nine months of 2013 compared to 2012. Additionally, the Company’s net sales for the first nine months of 2013 were negatively impacted by $31.5 million resulting from unfavorable fluctuations in foreign currency rates. The Company’s net sales by operating segment are presented below (dollars in millions):

	Nine Months Ended September 30,		Growth/(Decline)	
	2013	2012	Dollars	Percent
Net sales:				
Golf clubs	$603.6	$595.1	$8.5	1%
Golf balls	112.0	119.0	(7.0)	(6)%
	$715.6	$714.1	$1.5	—%

For further discussion of each operating segment’s results, see “Golf Clubs and Golf Balls Segments Results” below.
Net sales information by region is summarized as follows (dollars in millions):

	Nine Months Ended September 30,		Growth/(Decline)	
	2013	2012	Dollars	Percent
Net sales:				
United States	$351.1	$349.2	$1.9	1%
Europe	104.9	105.3	(0.4)	—%
Japan	129.4	120.9	8.5	7%
Rest of Asia	66.7	60.8	5.9	10%
Other countries	63.5	77.9	(14.4)	(18)%
	$715.6	$714.1	$1.5	—%

Net sales in the United States increased $1.9 million (1%) to $351.1 million during the nine months ended September 30, 2013 compared to the same period in the prior year. The Company’s sales in regions outside of the United States decreased $0.4 million to $364.5 million for the nine months ended September 30, 2013 compared to $364.9 million in the same period in 2012. The Company’s reported net sales in regions outside the United States in 2013 were unfavorably affected by the translation of foreign currency sales into U.S. Dollars based upon 2013 exchange rates. If

2012 exchange rates were applied to 2013 reported sales in regions outside the U.S. and all other factors were held constant, net sales in such regions would have been $31.5 million higher than reported in the first nine months of 2013.

The Company’s cost of sales is comprised primarily of material and component costs, distribution and warehousing costs, and overhead. In general, on a consolidated basis, approximately 80% - 85% of total cost of sales is variable in nature and will fluctuate with sales volumes. Of this amount, approximately 80% - 85% is comprised of material and component costs. Generally, the relative significance of the components of costs of sales does not vary materially from period to period. See “Segment Profitability” below for further discussion of gross margins.

Gross profit increased $46.7 million to $285.5 million for the nine months ended September 30, 2013 compared to $238.8 million in the comparable period of 2012. Gross profit as a percentage of net sales (“gross margin”) increased to 39.9% in the first nine months of 2013 compared to 33.4% in the first nine months of 2012. This increase in gross margin was primarily due to (i) a favorable shift in mix to sales of higher margin golf club products in 2013 compared to 2012; (ii) a decline in charges associated with the Company's Cost Reduction Initiatives; and (iii) improved manufacturing efficiencies resulting from the Cost Reduction Initiatives. These increases were partially offset by an increase in club component costs and the unfavorable impact of changes in foreign currency rates.

Selling expenses decreased by $32.9 million to $179.9 million (25.1% of net sales) during the nine months ended September 30, 2013 compared to $212.8 million (29.8% of net sales) in the comparable period of 2012. This decrease was primarily due to the Cost Reduction Initiatives, which resulted in a $15.8 million decline in employee costs, travel and entertainment, and expenses in connection with the Company's transition of its apparel and footwear businesses to a licensing model, in addition to a $12.2 million decrease in marketing expenses.

General and administrative expenses decreased by $0.3 million to $48.6 million (6.8% of net sales) during the nine months ended September 30, 2013 compared to $48.9 million (6.9% of net sales) in the comparable period of 2012. This decrease was primarily due to the Cost Reduction Initiatives, which resulted in a $5.9 million decline in employee costs, travel and entertainment and expenses in connection with the Company's wind-down of its GPS device business, in addition to a decrease of $3.2 million in professional fees and depreciation and amortization expense. This decrease was partially offset by the recognition of a $6.6 million net gain in connection with the sale of the Company’s Top-Flite and Ben Hogan brands during the first half of 2012, in addition to a $1.9 million increase in bad debt expense.

Research and development expenses were flat at $22.4 million (3.1% of net sales) in both the nine months ended September 30, 2013 and 2012.

Other income (expense), net increased to other income of $0.9 million during the nine months ended September 30, 2013 compared to other expense of $4.2 million in the comparable period of 2012. This improvement was primarily due to an increase in net foreign currency gains, partially offset by an increase in interest expense.

The Company’s provision for income taxes was $4.9 million during the nine months ended September 30, 2013, compared to $2.7 million in the comparable period of 2012. The $2.2 million increase resulted from the sale of indefinite lived assets relating to the Top-Flite and Ben Hogan brands in the first quarter of 2012. Due to the effects of the Company’s valuation allowance against its U.S. deferred tax assets, the Company’s effective tax rate for 2013 is not comparable to the effective tax rate for 2012 as the Company’s income tax amount is not directly correlated to the amount of its pretax income.

Net income for the nine months ended September 30, 2013 improved by $82.8 million to $30.6 million compared to a net loss of $52.2 million in the comparable period of 2012. Diluted earnings per share increased to $0.36 in the first nine months of 2013 compared to diluted losses per share of $(0.91) in the comparable period of 2012. The Company's net income for the first nine months of 2013 and 2012 includes the following charges and gains (in millions):

	Nine Months Ended September 30,	
	2013	2012
Pre-tax charges related to the Cost Reduction Initiatives	$(10.4)	$(39.8)
Pre-tax gain on the sale of brands	—	6.6
Income tax provision[1]	(4.9)	(2.7)
Total charges	$(15.3)	$(35.9)

(1) The Company's income tax provision for 2013 and 2012 is affected by the establishment of a valuation allowance against the Company's U.S. deferred tax assets and is therefore not directly correlated to the amount of its pretax income. See Note 12 "Income Taxes" to the Notes to Consolidated Condensed Financial Statements included in this Form 10-Q.

Golf Clubs and Golf Balls Segments Results for the Nine Months Ended September 30, 2013 and 2012

Golf Clubs Segment

Net sales information by product category is summarized as follows (dollars in millions):

	Nine Months Ended September 30,		Growth/(Decline)	
	2013	2012	Dollars	Percent
Net sales:				
Woods	$228.0	$180.4	$47.6	26%
Irons	152.5	147.2	5.3	4%
Putters	75.8	78.7	(2.9)	(4)%
Accessories and other	147.3	188.8	(41.5)	(22)%
	$603.6	$595.1	$8.5	1%

The $47.6 million (26%) increase in net sales of woods to $228.0 million for the nine months ended September 30, 2013 resulted from an increase in both sales volume and average selling prices. The increase in sales volume was primarily due to the successful launch of the X Hot family of woods, which performed better at retail than the prior year Razr X family of woods. The increase in average selling prices was due to the introduction of the X Hot and Razr Fit Xtreme woods at higher average selling prices than their predecessors, the Razr X and Razr Fit woods sold in the same period of the prior year.

The $5.3 million (4%) increase in net sales of irons to $152.5 million for the nine months ended September 30, 2013 was primarily attributable to the strong performance of the current year X Hot irons and Mack Daddy 2 wedges combined with an increase in average selling prices resulting from less promotional activity in the current year as a result of healthier inventory levels at retail.

The $2.9 million (4%) decrease in net sales of putters to $75.8 million for the nine months ended September 30, 2013 was primarily attributable to a decline in both sales volume and average selling prices due to an overall decline in the putter category this year. Despite this decline in sales, the Company's Odyssey brand of putters increased its year to date U.S. market share by approximately 200 basis points.

The $41.5 million (22%) decrease in net sales of accessories and other products to $147.3 million for the nine months ended September 30, 2013 was primarily due to a decline in net sales of approximately $20.4 million due to the transition of the Company's apparel and footwear businesses in the U.S. to a licensing arrangement during the second half of 2012, combined with a decline in sales of packaged sets, GPS devices, gloves and accessories.

Golf Balls Segment

Net sales information for the golf balls segment is summarized as follows (dollars in millions):

	Nine Months Ended September 30,		Decline	
	2013	2012	Dollars	Percent
Net sales:				
Golf balls	$112.0	$119.0	$(7.0)	(6)%

The $7.0 million (6%) decrease in net sales of golf balls to $112.0 million for the nine months ended September 30, 2013 was primarily due to a decline in sales volume and average selling prices. The decrease in sales volume was primarily due to a $18.9 million decline in sales of Top-Flite golf balls due to the sale of the Top-Flite brand in 2012 partially offset by an increase in sales of Callaway golf balls during the first nine months of 2013 compared to the same period in the prior year. The decline in average selling prices resulted from a shift in product mix to sales of lower priced golf ball models in 2013 compared to sales of higher priced premium golf ball models in 2012. In addition, golf ball sales in 2013 were negatively impacted by a decline in rounds played compared to rounds played in 2012.

Cost of Sales and Segment Profitability

The Company’s cost of sales is comprised primarily of material and component costs, distribution and warehousing costs, and overhead. In general, approximately 65% - 70% and 85% - 90% of the Company’s golf ball and golf club cost of sales, respectively, is variable in nature. Of these amounts, approximately 75% - 80% and 80% - 85%, respectively, is comprised of material and component costs. Generally, the relative significance of the components of costs of sales does not vary materially from period to period.

Profitability by operating segment is summarized as follows (dollars in millions):

	Nine Months Ended September 30,		Growth	
	2013	2012	Dollars	Percent
Income (loss) before income taxes:				
Golf clubs[1]	$60.4	$(7.2)	$67.6	933%
Golf balls[1]	3.5	(8.0)	11.5	143%
Reconciling items[2]	(28.4)	(34.3)	5.9	17%
	$35.5	$(49.5)	$85.0	172%

(1) In connection with the Cost Reduction Initiatives (see Note 2 "Cost Reduction Initiatives" to the Notes to Consolidated Condensed Financial Statements), during the nine months ended September 30, 2013 and 2012, the Company’s golf clubs segment recognized $4.3 million and $25.3 million, respectively, and the golf balls segment recognized $4.7 million and $9.7 million, respectively, in pre-tax charges related to these initiatives.

(2) Reconciling items represent corporate general and administrative expenses and other income (expense) not included by management in determining segment profitability. For the nine months ended September 30, 2013 and 2012, the reconciling items include pre-tax charges of $1.4 million and $4.8 million, respectively, related to the Cost Reduction Initiatives, and for the nine months ended September 30, 2012, the reconciling items include a pre-tax gain of $6.6 million in connection with the sale of the Top-Flite and Ben Hogan brands.

Pre-tax income in the Company’s golf clubs operating segment increased to $60.4 million for the nine months ended September 30, 2013 from a loss of $7.2 million for the comparable period in the prior year. This increase was primarily driven by an increase in gross margin, combined with an increase in net sales as discussed above and a decrease in operating expenses as a result of net savings realized from the Cost Reduction Initiatives. The increase in gross margin was primarily driven by (i) a favorable shift in sales mix from sales of lower margin golf accessories to increased sales of higher margin golf club products primarily related to the current year success of the X Hot family of clubs; (ii) a decline in charges associated with the Company's Cost Reduction Initiatives; and (iii) improved manufacturing efficiencies and lower costs resulting from the Company's Cost Reduction Initiatives.

These increases were partially offset by an increase in club component costs due to more expensive materials and technology incorporated into the X Hot family of woods and White Hot Pro putters, in addition to an unfavorable impact of foreign currency exchange rates.

Pre-tax income in the Company's golf balls operating segment increased to $3.5 million for the nine months ended September 30, 2013 from a loss of $8.0 million for the comparable period in the prior year. This increase was primarily attributable to a decrease in operating expenses as a result of net savings realized from the Cost Reduction Initiatives combined with an increase in gross margin, offset by a decrease in net sales as discussed above. The increase in gross margin was primarily driven by a decline in charges associated with the Company's Cost Reduction Initiatives combined with less promotional activity in 2013 compared to the same period in the prior year. In 2012, the Company had more closeout activity in connection with the sale of the Top-Flite brand. These increases were partially offset by an unfavorable shift in sales mix during the first nine months of 2013 to higher sales of range and value priced golf balls from sales of premium golf balls in the comparable period of 2012.

Financial Condition

The Company's cash and cash equivalents decreased $14.6 million to $37.4 million at September 30, 2013 from $52.0 million at December 31, 2012. The Company's cash and cash equivalents fluctuate with the seasonality of the Company's business and are affected by the timing of product launches. Generally, during the first quarter, the Company will rely more heavily on its credit facility to fund operations as cash inflows from operations begin to increase during the second quarter as a result of cash collections from customers. The Company's net cash provided by operating activities increased to $7.6 million during the nine months ended September 30, 2013 as compared to cash used in operating activities of $29.3 million during the nine months ended September 30, 2012 . The Company used its cash and cash equivalents and cash generated from operating activities in the first nine months of 2013 to fund $8.9 million in capital expenditures and $7.2 million in other investing activities. Management expects to fund the Company's future operations from current cash balances and cash provided by its operating activities combined with borrowings from the ABL Facility, as deemed necessary (see further information on the ABL Facility below).

The Company's accounts receivable balance fluctuates throughout the year as a result of the general seasonality of the Company's business. The Company's accounts receivable balance will generally be at its highest during the first and second quarters and decline significantly during the third and fourth quarters as a result of an increase in cash collections and lower sales. As of September 30, 2013, the Company's net accounts receivable increased $66.3 million to $157.4 million from $91.1 million as of December 31, 2012. The increase in accounts receivable reflects the general seasonality of the business and was primarily attributable to net sales of $178.2 million during the third quarter of 2013 compared to net sales of $119.9 million during the fourth quarter of 2012. The Company's net accounts receivable as of September 30, 2013 increased by $13.7 million compared to the Company's net accounts receivable as of September 30, 2012. This increase was primarily attributable to the $30.3 million increase in net sales in the third quarter of 2013 compared to the third quarter of 2012.

The Company's inventory balance also fluctuates throughout the year as a result of the general seasonality of the Company's business. Generally, the Company's buildup of inventory levels begins during the fourth quarter and continues heavily into the first quarter as well as into the beginning of the second quarter in order to meet demand during the height of the golf season. Inventory levels start to decline toward the end of the second quarter and are at their lowest during the third quarter. Inventory levels are also impacted by the timing of new product launches. The Company's net inventory decreased $20.8 million to $190.9 million as of September 30, 2013 compared to $211.7 million as of December 31, 2012. The decrease in inventory reflects the general seasonality of the business. The Company's net inventory remained relatively flat as of September 30, 2013 compared to September 30, 2012. Net inventories as a percentage of the trailing 12 months net sales increased to 22.8% as of September 30, 2013 compared to 21.8% as of September 30, 2012.

Liquidity and Capital Resources

The information set forth in Note 3 "Financing Arrangements," to the Consolidated Condensed Financial Statements included in Part I, Item I, of this Quarterly Report, is incorporated herein by this reference.

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Liquidity

The Company's principal sources of liquidity consist of its existing cash balances, funds expected to be generated from operations and the ABL Facility. Over the past four years, the Company has experienced revenue declines and incurred significant losses, including negative cash flows from operations in 2012. During the second half of 2012, the Company implemented significant changes to its business, including among other things, steps designed to increase product sales as well as initiatives designed to reduce the Company's manufacturing costs and operating expenses. The Company believes these initiatives will increase the Company's cash flows from operations in 2013. Based upon the Company's current cash balances, its estimates of funds expected to be generated from operations in 2013, and current and projected availability under the ABL Facility, the Company believes that it will be able to finance current and planned operating requirements, capital expenditures, contractual obligations and commercial commitments for at least the next 12 months.

The Company's ability to generate sufficient positive cash flows from operations is subject to many risks and uncertainties, including future economic trends and conditions, the success of the Company's multi-year turnaround, demand for the Company's products, foreign currency exchange rates, and other risks and uncertainties applicable to the Company and its business (see "Risk Factors" contained in Part I, Item 1A of its Annual Report on Form 10-K for the year ended December 31, 2012). While management believes the Company's recovery is on track, no assurance can be given that the Company will be able to generate sufficient operating cash flows in the future or maintain or grow its existing cash balances. If the Company is unable to generate sufficient cash flows to fund its business due to a further decline in sales or otherwise and is unable to reduce its manufacturing costs and operating expenses to offset such decline, the Company will need to increase its reliance on the ABL Facility for needed liquidity. If the ABL Facility is not then available or sufficient and the Company could not secure alternative financing arrangements, the Company's future operations would be significantly, adversely affected.

As of September 30, 2013, a significant portion of the Company's total cash is held in regions outside of the U.S. Outside of settling intercompany balances during the normal course of operations, the Company may repatriate funds from its foreign subsidiaries. The Company has not, nor does it anticipate the need to, repatriate funds to the United States to satisfy domestic liquidity needs arising in the ordinary course of business, including liquidity needs associated with its domestic debt service requirements. As such, the Company considers the undistributed earnings of its foreign subsidiaries to be indefinitely reinvested and, accordingly, no U.S. income taxes have been provided thereon. If in the future the Company decides to repatriate such foreign earnings, it would need to accrue and pay incremental U.S. federal and state income tax, reduced by the current amount of available U.S. federal and state net operating loss and tax credit carryforwards.

Other Significant Cash and Contractual Obligations

The following table summarizes certain significant cash obligations as of September 30, 2013 that will affect the Company's future liquidity (in millions):

	Payments Due By Period				
	Total	Less than 1 Year	1-3 Years	4-5 Years	More than 5 Years
Convertible notes[1]	$112.5	$—	$—	$—	$112.5
Interest on convertible notes[1]	24.9	4.2	8.6	8.4	3.7
Unconditional purchase obligations[2]	60.5	43.8	16.4	0.3	—
Operating leases[3]	32.8	12.5	13.8	5.1	1.4
Uncertain tax contingencies[4]	8.5	1.9	0.8	2.2	3.6
Total	$239.2	$62.4	$39.6	$16.0	$121.2

(1) In August 2012, the Company issued $112.5 million of convertible notes due August 15, 2019. Interest of 3.75% per year on the principal amount is payable semiannually in arrears on February 15 and August 15 of each year.

(2) During the normal course of its business, the Company enters into agreements to purchase goods and services, including purchase commitments for production materials, endorsement agreements with professional golfers and

other endorsers, employment and consulting agreements, and intellectual property licensing agreements pursuant to which the Company is required to pay royalty fees. It is not possible to determine the amounts the Company will ultimately be required to pay

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under these agreements as they are subject to many variables including performance-based bonuses, reductions in payment obligations if designated minimum performance criteria are not achieved, and severance arrangements. The amounts listed approximate minimum purchase obligations, base compensation, and guaranteed minimum royalty payments the Company is obligated to pay under these agreements. The actual amounts paid under some of these agreements may be higher or lower than the amounts included. In the aggregate, the actual amount paid under these obligations is likely to be higher than the amounts listed as a result of the variable nature of these obligations. In addition, the Company also enters into unconditional purchase obligations with various vendors and suppliers of goods and services in the normal course of operations through purchase orders or other documentation or that are undocumented except for an invoice. Such unconditional purchase obligations are generally outstanding for periods less than a year and are settled by cash payments upon delivery of goods and services and are not reflected in this line item.

(3) The Company leases certain warehouse, distribution and office facilities, vehicles and office equipment under operating leases. The amounts presented in this line item represent commitments for minimum lease payments under non-cancelable operating leases.

(4) Amount represents total uncertain income tax positions. For further discussion see Note 12 “Income Taxes” to the Consolidated Condensed Financial Statements in this Form 10-Q.

During its normal course of business, the Company has made certain indemnities, commitments and guarantees under which it may be required to make payments in relation to certain transactions. These include (i) intellectual property indemnities to the Company’s customers and licensees in connection with the use, sale and/or license of Company products or trademarks; (ii) indemnities to various lessors in connection with facility leases for certain claims arising from such facilities or leases; (iii) indemnities to vendors and service providers pertaining to the goods or services provided to the Company or based on the negligence or willful misconduct of the Company; and (iv) indemnities involving the accuracy of representations and warranties in certain contracts.

In addition, the Company has made contractual commitments to each of its officers and certain other employees providing for severance payments, including salary continuation, upon the termination of employment by the Company for convenience or by the officer for substantial cause. In addition, in order to assure that the officers would continue to provide independent leadership consistent with the Company’s best interest, the contracts also generally provide for certain protections in the event of an actual or threatened change in control of the Company. These protections include the payment of certain severance benefits, such as salary continuation, upon the termination of employment following a change in control.

The Company also has consulting agreements that provide for payment of nominal fees upon the issuance of patents and/or the commercialization of research results. The Company has also issued guarantees in the form of a standby letter of credit as security for contingent liabilities under certain workers’ compensation insurance policies. The duration of these indemnities, commitments and guarantees varies, and in certain cases may be indefinite. The majority of these indemnities, commitments and guarantees do not provide for any limitation on the maximum amount of future payments the Company could be obligated to make. Historically, costs incurred to settle claims related to indemnities have not been material to the Company’s financial position, results of operations or cash flows. In addition, the Company believes the likelihood is remote that payments under the commitments and guarantees described above will have a material effect on the Company’s financial condition. The fair value of indemnities, commitments and guarantees that the Company issued during the nine months ended September 30, 2013 was not material to the Company’s financial position, results of operations or cash flows.

In addition to the contractual obligations listed above, the Company’s liquidity could also be adversely affected by an unfavorable outcome with respect to claims and litigation that the Company is subject to from time to time. See Note 13 “Commitments & Contingencies” to the Notes to Consolidated Condensed Financial Statements and “Legal Proceedings” in Item 1 of Part II in this Form 10-Q.

Capital Expenditures

The Company does not currently have any material commitments for capital expenditures. The Company expects to have capital expenditures of approximately $15.0 million for the year ending December 31, 2013.

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Off-Balance Sheet Arrangements

At September 30, 2013, the Company had total outstanding commitments on non-cancelable operating leases of approximately $32.8 million related to certain warehouse, distribution and office facilities, vehicles as well as office equipment. Lease terms range from 1 to 7 years expiring at various dates through September 2020, with options to renew at varying terms.

Critical Accounting Policies and Estimates

There have been no material changes to our critical accounting policies and estimates from the information provided in Part II, Item 7, "Management's Discussion and Analysis of Financial Condition and Results of Operations," included in our Form 10-K for the fiscal year ended December 31, 2012.

Item 3. Quantitative and Qualitative Disclosures about Market Risk

The Company uses derivative financial instruments for hedging purposes to limit its exposure to changes in foreign currency exchange rates. Transactions involving these financial instruments are with creditworthy firms. The use of these instruments exposes the Company to market and credit risk which may at times be concentrated with certain counterparties, although counterparty nonperformance is not anticipated. The Company is also exposed to interest rate risk from the ABL Facility.

Foreign Currency Fluctuations

In the normal course of business, the Company is exposed to gains and losses resulting from fluctuations in foreign currency exchange rates relating to transactions of its international subsidiaries, including certain balance sheet exposures (payables and receivables denominated in foreign currencies) (see Note 16 "Derivatives and Hedging" to the Notes to Consolidated Condensed Financial Statements). In addition, the Company is exposed to gains and losses resulting from the translation of the operating results of the Company's international subsidiaries into U.S. dollars for financial reporting purposes. As part of its strategy to manage the level of exposure to the risk of fluctuations in foreign currency exchange rates, the Company uses derivative financial instruments in the form of foreign currency forward contracts and put and call option contracts ("foreign currency exchange contracts") to hedge transactions that are denominated primarily in British Pounds, Euros, Japanese Yen, Canadian Dollars, Australian Dollars and Korean Won. For most currencies, the Company is a net receiver of foreign currencies and, therefore, benefits from a weaker U.S. dollar and is adversely affected by a stronger U.S. dollar relative to those foreign currencies in which the Company transacts significant amounts of business.

Foreign currency exchange contracts are used only to meet the Company's objectives of offsetting gains and losses from foreign currency exchange exposures with gains and losses from the contracts used to hedge them in order to reduce volatility of earnings. The extent to which the Company's hedging activities mitigate the effects of changes in foreign currency exchange rates varies based upon many factors, including the amount of transactions being hedged. The Company generally only hedges a limited portion of its international transactions. The Company does not enter into foreign currency exchange contracts for speculative purposes. Foreign currency exchange contracts generally mature within twelve months from their inception.

The Company does not designate foreign currency exchange contracts as derivatives that qualify for hedge accounting under ASC 815, "Derivatives and Hedging." As such, changes in the fair value of the contracts are recognized in earnings in the period of change. At September 30, 2013 and December 31, 2012, the notional amounts of the Company's foreign currency exchange contracts used to hedge the exposures discussed above were approximately $102.4 million and $137.1 million, respectively. At September 30, 2013 and December 31, 2012, there were no outstanding foreign exchange contracts designated as cash flow hedges for anticipated sales denominated in foreign currencies.

As part of the Company's risk management procedure, a sensitivity analysis model is used to measure the potential loss in future earnings of market-sensitive instruments resulting from one or more selected hypothetical changes in interest rates or foreign currency values. The sensitivity analysis model quantifies the estimated potential effect of unfavorable movements of 10% in foreign currencies to which the Company was exposed at September 30, 2013 through its foreign currency exchange contracts.

The estimated maximum one-day loss from the Company's foreign currency exchange contracts, calculated using the sensitivity analysis model described above, is $10.7 million at September 30, 2013. The Company believes that such a hypothetical loss from its foreign currency exchange contracts would be partially offset by increases in the value of the underlying transactions being hedged.

The sensitivity analysis model is a risk analysis tool and does not purport to represent actual losses in earnings that will be incurred by the Company, nor does it consider the potential effect of favorable changes in market rates. It also does not represent the maximum possible loss that may occur. Actual future gains and losses will differ from those estimated because of changes or differences in market rates and interrelationships, hedging instruments and hedge percentages, timing and other factors.

Interest Rate Fluctuations

The Company is exposed to interest rate risk from its ABL Facility. Outstanding borrowings under the ABL Facility accrue interest as described in Note 3 to the Company’s Consolidated Condensed Financial Statements in this Form 10-Q and in “Liquidity and Capital Resources” above. As part of the Company’s risk management procedures, a sensitivity analysis was performed to determine the impact of unfavorable changes in interest rates on the Company’s cash flows. The sensitivity analysis quantified that the incremental expense incurred by an increase of 10% in interest rates is $0.2 million at September 30, 2013.

Item 4. Controls and Procedures

Disclosure Controls and Procedures. The Company carried out an evaluation, under the supervision and with the participation of the Company’s management, including the Company’s Chief Executive Officer and Chief Financial Officer, of the effectiveness, as of September 30, 2013, of the Company’s disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934). Based upon that evaluation, the Chief Executive Officer and Chief Financial Officer concluded that the Company’s disclosure controls and procedures are effective.

Changes in Internal Control over Financial Reporting. During the quarter ended September 30, 2013, there were no changes in the Company’s internal control over financial reporting that have materially affected, or are reasonably likely to materially affect, the Company’s internal control over financial reporting.

Because of the inherent limitations of internal control over financial reporting, including the possibility of collusion or improper management override of controls, material misstatements due to error or fraud may not be prevented or detected on a timely basis. Also, projections of any evaluation of the effectiveness of the internal control over financial reporting to future periods are subject to the risk that the controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

PART II. OTHER INFORMATION

Item 1. Legal Proceedings

The information set forth in Note 13 “Commitments & Contingencies,” to the Consolidated Condensed Financial Statements included in Part I, Item 1, of this Quarterly Report, is incorporated herein by this reference.

Item 1A. Risk Factors

Certain Factors Affecting Callaway Golf Company

The Company has included in Part I, Item 1A of its Annual Report on Form 10-K for the year ended December 31, 2012, a description of certain risks and uncertainties that could affect the Company’s business, future performance or financial condition (the “Risk Factors”). There are no material changes from the disclosure provided in the Form 10-K for the year ended December 31, 2012 with respect to the Risk Factors. Investors should consider the Risk Factors prior to making an investment decision with respect to the Company’s stock.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

Stock Purchases

In November 2007, the Board of Directors authorized a repurchase program (the “November 2007 repurchase program”) for the Company to repurchase shares of its common stock up to a maximum cost to the Company of $100.0 million, which will remain in effect until completed or otherwise terminated by the Board of Directors.

During the three months ended September 30, 2013, the Company did not repurchase any additional shares of its common stock under the November 2007 repurchase program. As of September 30, 2013, the Company remained authorized to repurchase up to an additional $72.4 million of its common stock under this program.

Item 3. Defaults upon Senior Securities

None.

Item 4. Mine Safety Disclosures

None

Item 5. Other Information

None.

Item 6. Exhibits

3.1	Certificate of Incorporation, incorporated herein by this reference to Exhibit 3.1 to the Company’s Current Report on Form 8-K, as filed with the Commission on July 1, 1999 (file no. 1-10962).
3.2	Fifth Amended and Restated Bylaws, as amended and restated as of November 18, 2008, incorporated herein by this reference to Exhibit 3.1 to the Company’s Current Report on Form 8-K, as filed with the Commission on November 21, 2008 (file no. 1-10962).
3.3	Amended and Restated Certificate of Designation for 7.50% Series B Cumulative Perpetual Convertible Preferred Stock, incorporated herein by this reference to Exhibit 3.1 to the Company’s Current Report on Form 8-K, as filed with the Commission on March 5, 2010 (file no. 1-10962).
4.1	Form of Specimen Stock Certificate for Common Stock, incorporated herein by this reference to Exhibit 4.1 to the Company’s Current Report on Form 8-K, as filed with the Commission on September 15, 2009 (file no. 1-10962).
4.2	Form of Specimen Stock Certificate for 7.50% Series B Cumulative Perpetual Convertible Preferred Stock, incorporated herein by this reference to Exhibit 4.2 to the Company’s Current Report on Form 8-K, as filed with the Commission on September 15, 2009 (file no. 1-10962).
4.3	Indenture, dated as of August 29, 2012 between Callaway Golf Company and Wilmington Trust, National Association, as Trustee, incorporated herein by reference to Exhibit 4.1 to the Company’s Current Report on Form 8-K, as filed with the Commission on September 4, 2012 (file No. 1-10962).
4.4	Global Note due 2019.†
10.1	Form of Exchange Agreement, incorporated herin by this reference to Exhibit 10.1 to the Company's Current Report on Form 8-K, as filed with the Commission on August 15, 2013 (file No. 1-10962).
10.2	Second Amendment to Second Amended and Restated Loan and Security Agreement, dated as of September 5, 2013, among Callaway Golf Company and certain of its subsidiaries, and Bank of America, N.A., as administrative agent and as security trustee for the Lenders.†
31.1	Certification of Oliver G. Brewer III pursuant to Rule 13a-14(a) or 15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.†
31.2	Certification of Bradley J. Holiday pursuant to Rule 13a-14(a) or 15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.†
32.1	Certification of Oliver G. Brewer III and Bradley J. Holiday pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.†
101.1	XBRL Instance Document*
101.2	XBRL Taxonomy Extension Schema Document*
101.3	XBRL Taxonomy Extension Calculation Linkbase Document*
101.4	XBRL Taxonomy Extension Definition Linkbase Document*

101.5	XBRL Taxonomy Extension Label Linkbase Document*
101.6	XBRL Taxonomy Extension Presentation Linkbase Document*

(†) Included with this Report.

* The XBRL information is being furnished and not filed for purposes of Section 18 of the Securities Exchange Act of 1934, as amended, and is not incorporated by reference into any registration statement under the Securities Act of 1933, as amended.

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

CALLAWAY GOLF COMPANY

By:	/s/ Jennifer Thomas
	Jennifer Thomas
	Vice President and
	Chief Accounting Officer

Date: October 25, 2013

EXHIBIT INDEX

Exhibit	Description
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